Prince Edward Island
Budget Highlights 2003-2004

Fiscal Responsibility in the New Millennium

Presented by
The Honourable Patricia J. Mella
Provincial Treasurer
April 10, 2003

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Prince Edward Island

Budget Highlights 2003-2004

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Prince Edward Island

Budget Highlights 2003-2004

Fiscal Responsibility in the New Millennium

Overview

Priority Areas

- Health Care
- Education
- Job Creation
- Community Development

The legacy of responsible fiscal management is clearly paying off for Prince Edward Island and we are able to weather the economic and fiscal volatility that characterize the start of the new millennium.

Patricia J. Mella
Provincial Treasurer

Budget Summary:

	2003-2004 Estimate ($ millions)	2002-2003 Forecast ($ millions)	2002-2003 Estimate ($ millions)
Revenue:			
Provincial Own Sources	610.2	608.0	591.3
Federal Sources	404.1	358.2	366.1
Sinking Fund Earnings	13.2	16.3	16.1
Operating Revenue	**1,027.5**	**982.5**	**973.5**
Expenditure:			
Program Expenditures	911.8	870.7	859.2
Interest Charges on Debt	105.4	100.9	106.5
Operating Expenditure	**1,017.2**	**971.6**	**965.7**
Operating Fund Surplus Before Net Capital Expenditures	**10.3**	**10.9**	**7.8**
Capital			
Capital Revenue	1.5	3.4	0.7
Capital Expenditures	34.7	42.4	37.4
Net Capital Expenditures	33.2	39.0	36.7
Operating Fund Deficit	**(22.9)**	**(28.1)**	**(28.9)**
Changes in Accounting and Budgetary Policy			
Change in Tangible Capital Assets Policy	12.6	28.9	26.2
Net Deficit of Crown Entities	(1.1)	(8.8)	(10.0)
Consolidated Deficit	**(11.4)**	**(8.0)**	**(12.7)**

Forecast 2002-2003:

Forecast Consolidated Deficit is $8 million compared to the restated 2002-2003 Original Consolidated Deficit of $12.7 million.

Revenues:
Forecast Operating Revenues are up $9 million from 2002-2003 Budget Estimate even though Equalization is down by $15.9 million. The following are the major changes:

Equalization	($ 15.9 million)
Personal Income Tax	$ 8.0 million
Sales Tax	$ 6.9 million
Canada Health and Social Transfer	$ 4.6 million
Labour Market Development Agreement	$ 2.8 million
Property Tax	$ 1.3 million
Other	$ 1.3 million

Expenditures:
Forecast Operating Expenditures are up $5.9 million from 2002-2003 Budget Estimate in the following areas:

Labour Market Development Agreement	$ 2.8 million
Development Assistance	$ 2.5 million
Negotiated Salary Settlements	$ 1.9 million
Employment Development Agency	$ 1.4 million
School Construction	$ 1.3 million
School Board Funding	$ 1.2 million
Debt Charges	($ 5.6 million)
Other	$ 0.4 million

Budget Estimate 2003-2004:

Tax Measures:

(1) Health Tax on Tobacco will be raised by $7 per carton of 200 cigarettes with proportionate increases on related tobacco products.

(2) The Provincial Personal Income Tax disability credit will be raised from $4,400 to $5,400, commencing 2003. This will provide assistance to some 3,000 taxpayers and their families.

(3) Implementation of a teacher school supply tax credit calculated on allowable expenditures of $500 per year, against personal income tax.

(4) Elimination of provincial property tax on non-commercial facilities owned and operated by the Royal Canadian Legions across Prince Edward Island; and the non-commercial provincial property tax will be lifted for 2003 from 43 ports across the province.

(5) Municipalities will be exempt from provincial sales tax on purchases of liquid asphalt.

Revenues:

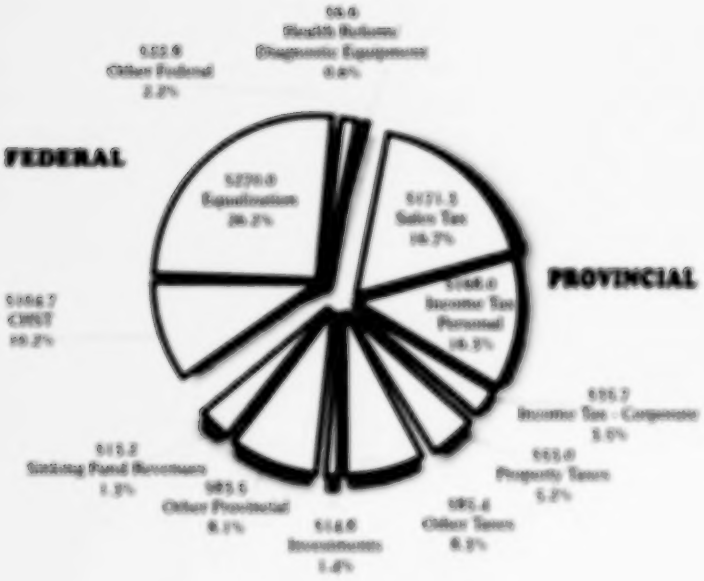
Provincial source revenues will increase 3.2% or $18.9 million from 2002-2003 Budget Estimates. This is due mainly to an increase in health tax on tobacco and increased growth in sales tax and property tax.

Federal source revenues will increase $38 million which is made up of an increase in equalization of $15 million and health funding of $22.3 million.

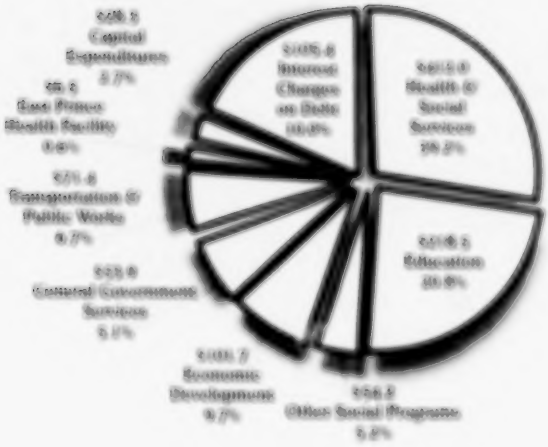
Expenditures:

Total operating expenditures are up $51.5 million over the 2002-2003 Budget Estimate. Salary increases represent $29 million of this increase while approximately $15 million went to Health and Education. The remaining $7.5 million, was disbursed to the other departments representing an increase of less than 1% of operating expenditures.

2003-2004 Revenues
Where the Money Comes From
($ millions)



2003-2004 Expenditures
Where the Money Goes
($ millions)



Achievements

- Eight family physicians and 10 specialists were recruited along with 42 physicians who provided locum services.
- Fourteen new nursing seats were established at the UPEI School of Nursing.
- A new Radiology Information System and associated Picture Archive and Communication System, the first in Canada implemented province-wide.
- Near completion of the new Prince County Hospital.
- In April 2002, an increase of 3% or $890,000 was provided to financial assistance recipients to keep pace with increased costs.
- Construction of an additional ten-bed unit as part of the long-term care facilities at Community Hospital in O'Leary is well underway.
- Three Family Health Centers, at Sherwood (Four Neighbourhoods), Hunter River and O'Leary were established.
- County-based diabetes management services have been expanded.
- The Best Start Home Visiting Program was expanded to all Island communities.

New Initiatives

- An additional $400,000 has been provided for early childhood development initiatives.

New Initiatives (continued)

- A new Seniors Home Repair Program will receive $200,000 to assist low income seniors with essential home repair costs.
- Additional $1 million has been provided to conduct repairs and capital improvements on health system facilities.
- A budget of $1.7 million has been established for new medical and diagnostic equipment and technologies for acute care, long-term care and information system.
- Funding of $375,000 has been allocated to provide new health services facilities adjacent to the Souris Hospital and allow for expansion of the Family Health Center in the Hospital.
- The establishment of the first MRI Diagnostic Imaging Service in the Province will be completed in July 2003 along with an enhancement to the Cancer Treatment Center to include Linear Accelerator in October 2003. Total capital cost of project is $12 million. An operational budget of $2.8 million has been provided in 2003-2004.
- Starting April 1, 2003, the Province will introduce a 3% increase to the financial assistance rates.
- Beginning this year, the implementation of a Meningococcal C Vaccination Program at a cost of $262,000.
- A Healthy Living Strategy will be implemented in consultation with the Departments of Education and Community and Cultural Affairs at a cost of $180,000.
- The Home Care and Support Program will be enhanced by expanding post-acute home nursing, tele-home care, home palliative care and in-home support services.

Education

Achievements

- Additions to three schools have been completed: Parkdale Elementary School, Miscouche Consolidated School and Kinkora Regional High School at a total cost of $7 million.
- Officially opened the new Francophone School and Community Centre (École Sur-Mer and Le Centre Belle-Alliance) in Summerside.
- Invested $1.8 million in major repairs for 28 schools.
- Provided school boards with additional funding of $1.2 million to meet increasing demands for services and also to hire 8.5 additional teachers.
- Completed the full implementation of a $1.8 million program to develop, test and implement a new mathematics curriculum from kindergarten to Grade 12.
- Completed Phase I of the Provincial Autism Strategy.
- Provided $300,000 to Atlantic Veterinary College to enhance teaching and research.
- Provided $400,000 to Holland College for the Aerospace and Industrial Technology Centre.
- Established a new division of Technology in Learning and opened a new Education Technology Centre to support the integration of technology into classrooms.

New Initiatives

- Government has approved, in principle, a new Staffing and Funding Model for the school boards.
- The Department will invest $1.2 million over three years to implement a new science curriculum.
- Increase operating grants to school boards by $500,000 in addition to maintaining the extra funding received in 2002.
- Increase funding to Island kindergartens.
- Bluefield Senior High and Summerside Intermediate will be renovated at a total cost of $12.0 million over two years.
- UPEI will receive an additional $1 million in 2003-2004.
- Holland College will receive an additional $1 million this year. Of this funding, $120,000 is allocated to improve trades curriculum.
- Atlantic Veterinary College will receive a further $500,000 this year to enhance teaching and research.
- MPHEC funding will increase $480,000 to support students studying in other Maritime provinces in programs not available on Prince Edward Island.
- Early literacy funding will be increased by $150,000.
- In-study income and scholarship exemptions in the P.E.I. Student Loan Program will be increased.
- The weekly loan limit for the Provincial Student Loan Program will increase from $110 per week of study to $165 per week of study.

Additional Funding

- Allocation of $850,000 to upgrade sewage treatment facilities at Cabot, Linkletter and Northumberland Provincial Parks.
- Additional $500,000 for general improvements to provincial parks and Visitor Information Centres.
- Future Farmer Program will be implemented to provide interest relief.
- This Budget provides for the funding of a new freshwater fisheries biologist.
- Establish new funding of $475,000 to implement the new Sports Strategy.
- Re-establish Transportation and Public Works Capital Budget.
- Additional funding of $500,000 for community development.
- Additional $343,500 to the Water Management Division to support its work in managing, protecting and enhancing our groundwater and surface water resources.
- Additional emphasis and funding of $75,000 for pesticide monitoring and control.
- Additional funding to support improvements in delivery of family law services.

Summary Statistics

	2001	2002
Population on 1 July (in '000s)*	138.9	139.9
Personal Income per capita* ($)	22,597	23,578[1]
As % of Canadian personal income	*80.5*	*82.2*[1]
Employment (in 000's)	65.9	67.1
Unemployment Rate - PEI (%)	11.9	12.1
Unemployment Rate - Canada (%)	*7.2*	*7.7*
CPI - Annual Change PEI (%)	2.6	2.7
CPI - Annual Change (%) Canada	*2.6*	*2.2*
Retail Trade ($ millions)*	1,281.3	1,324.8
New Motor Vehicle Sales (units)	4,635.0	4,996.0
Farm Cash Receipts ($ millions)*	337.4	369.6
Potato Receipts ($ millions)	126.0	194.2
Lobster Landings ($ millions)*	104.8	105.4
*Lobster Landings (lbs - millions)**	*19.4*	*19.9*
Housing Starts (units)	675	775
Investment ($ millions)	597.4	652.4
Manufacturing Shipments ($ millions)*	1,201.3	1,315.9
Tourist Expenditures ($ millions)	310.0	331.8
International Exports in Goods ($ millions)*	666.4	679.1
GDP at Market Prices ($ millions)*	3,480	3,692

* Revised Data

[1] Provincial Treasury estimate

Sources: Statistics Canada; CMHC;
PEI Fisheries, Aquaculture and Environment; Tourism PEI

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BUDGET ADDRESS 2003

Province of Prince Edward Island
Budget Address
2003

Presented by
The Honourable Patricia J. Mella

Provincial Treasurer
and
Chair of Treasury Board

Prince Edward Island

2003 Budget

Fiscal Responsibility in the New Millennium

Presented to
The Members of the Legislative Assembly of Prince Edward Island

by

Honourable Patricia J. Mella

Provincial Treasurer
and
Chair of Treasury Board

April 10, 2003

The full text of the Budget Address, Estimates of Revenue and Expenditure and supporting schedules for 2003-2004 and previous years are available from the Province of Prince Edward Island's website:

http://www.gov.pe.ca/budget

PRINCE EDWARD ISLAND
2003 BUDGET

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THE BUDGET ADDRESS

Fiscal Responsibility in the New Millennium

Madam Speaker, Members of the Legislative Assembly,

We have prepared this Budget while the world is dominated by the events taking place in the Middle East. The progress of the Iraq War is adding immensely to the global uncertainties that make economic forecasting and budgeting difficult.

Madam Speaker, these are very turbulent times, and I am pleased to report that Prince Edward Island has been able to achieve significant progress notwithstanding the global situation.

The Province has come through the events of the past three years in very good shape, when one considers all that has happened. In 2000 the Province had to deal with the problem of the potato embargo by the United States from the isolated case of potato wart. This was followed by the drought in 2001 which devastated our potato crop. At the same time financial markets in North America were hammered by the collapse of the technology sector and the accounting scandals. Toward the close of 2001, we witnessed the terrorist attacks in the United States and the devastation arising from the collapse of the New York World Trade Center towers, whose images still haunt us all. And now it is the situation in Iraq, whose final outcome has yet to be determined.

Madam Speaker, these are not ordinary times.

"Madam Speaker, these are very turbulent times, and I am pleased to report that Prince Edward Island has been able to achieve significant progress notwithstanding the global situation."

"Madam Speaker, these are not ordinary times."

It may be recalled that a year ago the Province anticipated a difficult budget year in 2002, primarily due to a predicted sharp drop in our federal support. In fact Equalization, our largest single revenue source, performed far worse than had been forecast. Notwithstanding the severity of the financial position we faced last year, I can announce that the Province's fiscal performance exceeded our expectations.

The legacy of responsible fiscal management is clearly paying off for Prince Edward Island and we are able to weather the economic and fiscal volatility that characterize the start of the new Millennium. Only a few years ago a downturn in federal support of the scale that occurred in 2002 would have triggered panic in this province.

"The legacy of responsible fiscal management is clearly paying off for Prince Edward Island..."

Madam Speaker, this Government found no reason to resort to the kind of extreme measures followed by the previous administrations when such adversity strikes. The Province is now well placed to take advantage of the opportunities that the new economic age brings and it is this economic vitality that underlies the resilience of the Province.

Our financial position for 2002-2003 is better than we had budgeted a year ago and our economic performance in 2002 was much stronger than any had expected.

"Our financial position for 2002-2003 is better than we had budgeted a year ago..."

Madam Speaker, the Budget for 2003-2004 is, as we had promised, a consolidated budget. This budget also contains new money for improved programs, targeted tax reductions and a bottom line basically in balance.

Accountability is a cornerstone of good government. It is important to note that the books of this Province show an accurate and complete description of expenditures and revenues.

"... the books of this Province show an accurate and complete description of expenditures and revenues."

Madam Speaker, it is evident that the trusteeship of the Province's economy and finances by this administration is one of the keys to the Province's success. It is my privilege to be part of the team that has been able to ensure that our strategy of being fiscally and economically responsible has paid off.

I would like to take this opportunity to thank all my colleagues who have participated in the making of this Budget.

"it is evident that the trusteeship of the Province's economy and finances by this administration is one of the keys to the Province's success."

Public Input

Madam Speaker, I noted a year ago that many aspects of our Provincial Budget are subject to the policies and complexities of federal programming. Prior to this Budget I decided that we would extend our public consultations and take the opportunity to explain more fully the environment within which we must operate as a Canadian province. We therefore held public meetings in various locations within the Province to both explain our financial situation and hear the views of Islanders.

We were very pleased with the response of the public to these meetings. In addition, we invited groups or individuals to talk to us in private if they so chose.

These meetings were very useful to us in shaping this Budget.

I am always encouraged by the interest shown by Islanders in the finances of the Province. We, the elected officials, are essentially the managers of the Province. It is the people of the Province who are essentially its owners and we must not forget this. I believe Islanders expect us to be fiscally responsible in all that we do. It is the taxpayers' dollars that are at stake and it is incumbent on us to use these hard earned dollars to foster the development of this province, economically and socially, and with respect to the environment.

" It is the people of the Province who are essentially its owners and we must not forget this."

I would like to thank all those who offered their advice and who took the time to come to the various venues to discuss the Budget. I encourage all Islanders to participate in this undertaking in the coming years.

Economic and Fiscal Performance

Madam Speaker, it may be recalled that a year ago the Provincial Budget was titled "A Balanced Response to Difficult Times". At that time we were aware that the United States economy had suffered a major slowdown in 2001 and that growth of the Canadian economy had been weak. At that time the Bank of Canada and the Federal Government were expecting a modest economic recovery in 2002, becoming progressively stronger through the year. The outlook was for Canadian growth of only 1.5% in 2002. But the uncertainties surrounding the Afghanistan situation, the prevailing pessimism in financial markets and the lack of business confidence globally made any prediction highly risky.

"... the prevailing pessimism in financial markets and the lack of business confidence globally made any prediction highly risky."

It may also be recalled that the monetary authorities responded to this weakness by lowering interest rates to extremely low levels. By November 2001 the United States Federal Funds rate was at 1.75%, where it remained until November 2002, when it was further lowered to 1.25%.

The United States economy expanded by only 2.4% in 2002. By contrast, the Canadian economy experienced a massive expansion in the first half of 2002, largely in response to the interest rate cuts. Overall, the Canadian economy grew by 3.4% in 2002 according to initial estimates by Statistics Canada, but growth in the fourth quarter slowed to 1.6%.

Madam Speaker, I am pleased to be able to announce that this Province's economic growth effectively matched that of Canada in 2002, at 3.3%. This was substantially better than had been expected at Budget time a year ago and is reflected in much improved revenue performance from our own source revenues. It reflects the resilience of the Island economy.

"I am pleased to be able to announce that this Province's economic growth effectively matched that of Canada in 2002, at 3.3%."

Madam Speaker, 2002 was a year for the record books.

Employment in 2002 measured 67,100 persons, an all-time high for the Province.

The value of manufactured goods produced on Prince Edward Island valued $1.3 billion, another all-time high.

The value of farm cash receipts was approximately $370 million, an all-time record.

"Employment in 2002 measured 67,100 persons, an all-time high for the Province."

Tourists spent a record $353 million on Prince Edward Island in 2002.

International exports of Island products amounted to $679 million, which was another record.

Housing starts jumped by 15% in 2002, the largest increase in 13 years.

Retail sales measured a record $1.3 billion, stimulated by an 8.7% increase in new motor vehicle sales.

"The Prince Edward Island economy is strong and has done very well despite the uncertainties that beset the world economy."

Finally, lobster landings were valued at $105 million, another all-time record.

Madam Speaker, the evidence is there for all to see. The Prince Edward Island economy is strong and has done very well despite the uncertainties that beset the world economy.

One can find more details on the economy in Budget Paper A in this address, which further documents this record breaking year.

This strong economic performance resulted in tax revenues performing well. Provincial sales tax revenues were up by $6.9 million, an increase of 4.3% from the previous year. Personal income tax revenues exceeded projections by $8 million. In total, own source revenues were $16.7 million above budget.

" In total, own source revenues were $16.7 million above budget."

Madam Speaker, while this is good news for the provincial finances in 2002, Equalization was a serious problem.

Equalization, our largest revenue, was budgeted to be $255 million in 2002-2003, down by $27 million from the previous year. It was largely because of this expected fall in revenue that we introduced the Workforce Adjustment Program, reduced programming in some areas and implemented significant reductions in the capital budget. These measures were undertaken to reduce current costs and contain costs for the future. The Workforce Adjustment Program was successful in meeting its target and resulted in departments working more closely and cooperatively.

"Equalization, our largest revenue, was budgeted to be $255 million in 2002-2003, down by $27 million from the previous year."

However, Equalization for 2002-2003 was under budget by $16 million which was $43 million less than the previous year and at its lowest level since 1997-1998.

One can therefore understand the importance that our own economic performance played in sustaining the Provincial Government's finances in 2002-2003.

Under these circumstances, Madam Speaker, I am pleased to announce that in 2002-2003, with full consolidation of our accounts, the Province ran a deficit of only $8 million. This compares to the original Budget deficit under full consolidation of $12.7 million.

"... in 2002-2003, with full consolidation of our accounts, the Province ran a deficit of only $8 million. "

Further, the Operating Fund Surplus before expenditures on capital achieved a surplus of $10.9 million. The overall result, after consolidating government entities, indicates that for all practical purposes we effectively balanced the 2002-2003 Budget.

Interest charges on the debt were reduced from $107 million in 2001-2002 to $101 million in 2002-2003. I might remind my colleagues that by comparison, interest charges on the debt were a staggering $120 million in 1995-96.

Madam Speaker, included in this Address is a full description of the accounting and budgetary policy changes, in Budget Paper C.

Fiscal Issues

Madam Speaker, it is evident that the Equalization program remains a serious problem for the Province. It is easily our largest revenue source, it is very volatile, and it is very difficult to predict. Frankly, it makes Budgeting on Prince Edward Island a nightmare.

"Madam Speaker, it is evident that the Equalization program remains a serious problem for the Province."

I must emphasize that this Government, including the Premier, myself and my staff have invested a great deal of our energies in pressing the Federal Government at all levels to strengthen and improve the program so that it meets its constitutional commitment. This year is crucial because the present formula that determines the entitlements expires March 31, 2004. This year provides our last opportunity to advocate changes to improve its operation for the coming five years. But it must be borne in mind that the final say on whether these are acted upon remains with the federal Minister of Finance. We can submit proposals to the Finance Minister and his staff but cannot force him to accept them.

Madam Speaker, I am pleased to say that we have achieved some success already. The ceiling that was imposed on Equalization in 1982 will be permanently removed. This was announced by the Prime Minister on February 5, 2003 at the time of the First Ministers' Health discussions. In 2001, I had made personal interventions to the House of Commons Finance Committee and the Senate Finance Committee concerning the need to eliminate this ceiling. It appears that these submissions produced the desired result and we appreciate this change.

" I am pleased to say that we have achieved some success already. The ceiling that was imposed on Equalization in 1982 will be permanently removed."

Serious discussions are now underway between federal and provincial officials on changing the program to make it more predictable and more stable. Professionals in this area now acknowledge that the data requirements of the present formula are such that it has become effectively unpredictable. I know that my own officials are deeply involved in these discussions and we wish them success in producing a formula that is both predictable and stable for 2004-2005 and the future.

Madam Speaker, we are also advocating that the formula be strengthened by raising the bar to a national, ten-province standard, and by improving revenue coverage.

A return to the ten-province standard, which existed prior to 1982, would cause a significant enhancement in provincial entitlements. This would raise our revenue by some $25 million per year. It is our view that this is needed to reduce the growing disparities that are developing between poorer and richer provinces.

"A return to the ten-province standard, which existed prior to 1982, would cause a significant enhancement in provincial entitlements."

Madam Speaker, discussions concerning health care dominated federal provincial meetings this winter. The First Ministers met February 4 and 5 this year and produced the so called "Health Accord". Its terms were essentially dictated to Premiers by the Prime Minister and are nationally regarded as inadequate. Prince Edward Island does not acknowledge that an agreement was actually reached, regarding it as more of an arrangement.

The federal commitment is substantially less than that recommended by the Romanow Report.

Under the Health arrangement, the Federal Government will provide an additional $4.3 billion to provinces in the next five years as support for the Canada Health and Social Transfer. Thus, the overall CHST contribution to Prince Edward Island is now budgeted at $104.7 million, compared to approximately $94 million last year.

"Thus, the overall CHST contribution to Prince Edward Island is now budgeted at $104.7 million, compared to approximately $94 million last year."

Madam Speaker, in addition to the CHST supplement, the Health arrangement includes $1 billion for Health Reform in 2003-2004, and $500 million for Diagnostic and Medical Equipment. These transfers are conditional on provinces applying them to specific program areas to enhance health services. They total $6.6 million for Prince Edward Island in 2003-2004.

Details of the Health transfers and Equalization can be found in Budget paper B in this address.

"in addition to the CHST supplement, the Health arrangement includes $1 billion for Health Reform in 2003-2004, and $500 million for Diagnostic and Medical Equipment."

Economic and Fiscal Outlook

Madam Speaker, the prevailing economic situation plays a critical part in the development of the Budget. Inflation rates impact on all our costs of doing business, interest rates impact our borrowing costs, the performance of the national economy effects Equalization revenues, and our local economy directly impacts on how well our taxes perform.

It is our perspective that the Canadian economy is likely to grow at a substantially slower pace in 2003 than occurred in 2002. The Bank of Canada has been increasing interest rates for some time and the Governor has recently indicated that this might well continue. Furthermore, increasing inflation has become a factor, pushing up costs, largely in reaction to the sharp increase in energy costs that we are enduring. After several years of stable

prices, the Consumer Price Index increased by 4.3% in the last three months. The War in Iraq adds uncertainty to the global economic outlook.

Madam Speaker, in view of these uncertainties in the economy, I am sure this House would agree that it would be prudent to err on the side of caution in developing this Budget.

"Madam Speaker, in view of these uncertainties in the economy, I am sure this House would agree that it would be prudent to err on the side of caution in developing this Budget."

We estimate that the provincial economy will continue to grow in 2003, but at a reduced rate of 2%, compared to the 3.3% in 2002. Personal incomes will expand in 2003 in the order of 3.6% whereas in 2002 they increased by an estimated 5%. We foresee that our industrial performance will be broadly based. I might add, Madam Speaker, that while we have built prudence into the forecast, we could still be surprised by a possible serious deterioration in the global situation in the coming year. Naturally, there is also the prospect of a quick resolution to the Middle East conflict and much improved economic conditions generally.

Madam Speaker, the 2003-2004 Budget provides for a surplus on the Operating Account before capital of $10.3 million. After changes in accounting and budgetary policy, the total Consolidated Balance is expected to show a deficit of $11.4 million which compares to the $12.7 million budget deficit in 2002-2003. In light of overall operating expenditures of some $1 billion, this by any measure is effectively a balanced situation.

"... the total Consolidated Balance is expected to show a deficit of $11.4 million which compares to the $12.7 million budget deficit in 2002-2003."

Revenues in 2003-2004 are significantly impacted by an anticipated recovery in the Equalization entitlements and improved federal transfers for Health Care. However, Equalization revenue, at $270 million is still expected to be below that experienced in recent years.

The increase in the Canada Health and Social Transfer in 2003-2004 is $11 million, as described.

Madam Speaker, we have built a contingency into the federal transfers for the likely impact of the population revisions that are anticipated later in 2003, as a result of the 2001 Census. These contingencies amount to $17.5 million.

Own source revenues are expected to increase, but at a slower pace than in 2002-2003, reflecting the slower pace of economic expansion.

Program spending is budgeted at $911.8 million in 2003-2004, compared to $870.7 million in the forecast for 2002-2003, an increase of 4.7%. Health and Social Services will receive 45% of the total program expenditures.

"Program spending is budgeted at $911.8 million in 2003-2004..."

Revenue Measures

Madam Speaker, our government is committed to sustaining provincial services to Islanders and at the same time addressing specific needs, by providing targeted tax relief.

First, we will assist the disabled by providing an increase to the disability credit for income tax purposes from $4,400 to $5,400, commencing in the tax year 2003. This will provide financial assistance to some 3,000 taxpayers and their families on Prince Edward Island.

"we will assist the disabled by providing an increase to the disability credit for income tax purposes from $4,400 to $5,400..."

Second, the Province's teachers will be able to receive consideration for expenses incurred in purchasing specified school supplies with their own money. A provincial tax credit will be calculated on allowable expenditures of $500 in any given year. This will also be effective in the 2003 tax year, once suitable administrative arrangements have been developed.

Third, the Provincial portion of property tax on non commercial facilities owned and operated by the Royal Canadian Legions across Prince Edward Island, will be eliminated in 2003.

Also, the non-commercial provincial property tax will be removed in 2003 for the 43 ports across Prince Edward Island.

Finally, the purchase of liquid asphalt by Municipalities will be exempt from provincial sales tax once legislation is changed in this session of the Legislature.

Madam Speaker, the Province of Prince Edward Island continues to be concerned over the level of smoking that is prevalent today, especially among its young. We passed legislation in the Fall session that bans smoking from public places.

Our neighbours in Nova Scotia, Newfoundland and New Brunswick presently levy provincial taxes on cigarettes and tobacco products that are considerably higher than those on Prince Edward Island. In keeping with our efforts to lower smoking on the Island I will be raising the provincial Health Tax on Tobacco by $7 per carton of 200 cigarettes, effective at midnight tonight. Taxes on other tobacco products will be raised proportionately.

"...I will be raising the provincial Health Tax on Tobacco by $7 per carton of 200 cigarettes, effective at midnight tonight."

Initiatives in 2003-2004

Madam Speaker, in addition to these tax changes, we will be implementing a number of new initiatives which reflect the priorities of our government.

Health Care

The Department of Health and Social Services has a Budget of $412.1 million in the coming year and will receive $20 million of the $52 million increase in overall level of Program spending scheduled for 2003-2004. Health care is clearly our largest expenditure priority. This budget contains $6.2 million in new health and social service initiatives including $1.7 million for medical and long term health care equipment and early childhood development initiatives of $400,000.

"Health care is clearly our largest expenditure priority. This budget contains $6.2 million in new health and social service initiatives ..."

Madam Speaker we are pleased to announce again this year an increase of 3% to financial rates, effective April 1, 2003, for Social Assistance recipients.

A new Seniors Home Repair Program will receive $200,000 to assist low income seniors with essential repair costs. Moreover, we will provide funding for the PEI Senior Citizens Federation to hire a full-time coordinator to assist more than 45 seniors clubs across Prince Edward Island.

"A new Seniors Home Repair Program will receive $200,000 to assist low income seniors with essential repair costs."

Madam Speaker, the Prince County Hospital is now nearing completion and will be ready to go into operation later this year. Included in this Budget is $6.5 million for the completion of the facility and $2.5 million for the start up and operational costs.

The Magnetic Resonance Imaging service will become available at the QEH this summer, along with an enhancement to the Cancer Treatment Centre to include a Linear Accelerator. The overall capital cost of these services is $12 million, including $800,000 for capital equipment and $2.8 million for operational costs in this budget.

"The Magnetic Resonance Imaging service will become available at the QEH this summer..."

The additional ten-bed unit at the Community Hospital in O'Leary is well underway and will also be completed this year.

Madam Speaker, the most important resource in Health and Social Services is its staff. There are now over 3,800 full time equivalent positions on the Island. Over $239 million, or 58% of expenditures in health are allocated to employee and physician costs, up 8.6% from 2002-2003.

We are grateful, Madam Speaker, to the men and women who continue to provide first class health care to Islanders.

Education

Madam Speaker, the future of Prince Edward Island is intrinsically tied to education. We cannot progress without an educated and informed population, and a proficient and productive work force. Information released in the recent Census demonstrated major gains in educational attainment over the past decade. On Prince Edward Island the working population with greater than high school education increased by 32% from 1991 to 2001.

The November Speech from the Throne stated that it was time for the spotlight to shine on learning. The education budget has increased $16.2 million and this is the single largest education budget increase in the Province's history.

Our post-secondary institutions, the University of Prince Edward Island and Holland College, will each receive an additional $1 million in 2003-2004. The extra money allocated to UPEI is meant to address the financial pressures the university faces with respect to tuition increases and so forth. Of the $1 million increase to this year's Holland College budget, $120,000 will be earmarked for enhancement to the college's resources in the areas of trades training. The Province's contribution to the Atlantic Veterinary College will increase this year by $500,000.

"Our post-secondary institutions, the University of Prince Edward Island and Holland College, will each receive an additional $1 million in 2003-2004."

Our community-based publicly-funded kindergarten now serves 1,605 children, comprising 98% of the eligible population. This budget provides additional funding directed to kindergartens to increase the wages of certified instructors.

"This budget provides additional funding directed to kindergartens to increase the wages of certified instructors."

Government has approved in principle a new model for the allocation of teaching staff to Island schools. This model, developed in consultation with the public and our education partners, will be phased in over a six-year period and will result in more teachers for Island classrooms. Island students are our future and therefore Government continues to invest in measures

that will improve the learning outcomes for our students.

To enable Island students to acquire a solid foundation to succeed in the emerging economy, we are committing $1.2 million over three years for the implementation of a new science curriculum at all grade levels in Island schools.

"...we are committing $1.2 million over three years for the implementation of a new science curriculum at all grade levels in Island schools."

The Province will also invest an additional $150,000 in support of English and French early literacy programs.

Our Government recognizes the importance of higher education and the commitment of those young Islanders who are improving themselves and their communities. To that end, I am pleased to announce that we are raising the student loan limit from $9,300 to $11,200, an increase of 20%. In addition, we are increasing the student in-study income from the present exemption of $600 to $1,700.

L'an dernier, nous avons officiellement ouvert le nouveau centre scolaire et communautaire francophone pour Summerside-Miscouche (École-sur-Mer et Centre Belle-Alliance). We officially opened the new Francophone School and community centre (École sur-Mer and Le Centre Belle-Alliance) in Summerside-Miscouche last year. Additions and renovations were completed at Parkdale Elementary School, Miscouche Consolidated School, and Kinkora Regional High School, worth $7 million in total. We invested $1.8 million in major repair work at 28 Island schools.

"L'an dernier, nous avons officiellement ouvert le nouveau centre scolaire et communautaire francophone pour Summerside-Miscouche (École-sur-Mer et Centre Belle-Alliance)."

Madam Speaker, I am pleased to announce that Phase II of the promised capital construction at Bluefield High School and Summerside Intermediate School will begin in this fiscal year. These projects will cost more than $6 million in this fiscal year and will fulfill a longstanding commitment Government has made to these school communities.

Our largest expense in Education is to provide for the salaries of the Island's 2,333 full-time teaching and other staff. In 2003-2004 an additional $7.3 million of the Education budget is allocated to salary increases. An essential component of education is our teachers to whom we owe a debt of gratitude and our sincere thanks.

Economic Development

Madam Speaker, it would be impossible for me to detail all the initiatives by this Government in economic development. I would emphasize that the economic success of Prince Edward Island is something we should all be very proud of and it is something we have, perhaps, been slow to acknowledge.

"All the indicators concerning our progress are positive, our living standard is rising and our economic self sufficiency is increasing."

All the indicators concerning our progress are positive, our living standard is rising and our economic self sufficiency is increasing.

Honeywell Inc., an international engineering and aerospace company, is expanding its Slemon Park Facility. The Food Technology Centre will be completing a 5,000 square foot expansion. In keeping with our Government's commitment to alternate sources of energy, the North Cape Wind Farm is being used as a test bed for new, larger windmills. Food Technology Centre scientists are working with the PEI Energy Corporation on alternative energy projects, such as using ethanol from barley to add to gasoline, and reduce emissions.

"The Atlantic Technology Centre is now open and the Province is supporting three rural technology centres across the Province."

The Atlantic Technology Centre is now open and the Province is supporting three rural technology centres across the Province. The ATC is a first class facility in the high-tech world of computers, information technology and media production. Master Packaging is expanding its Borden-Carleton plant and will be employing 70 more Islanders. Helipro Airframe is completing renovations for its Slemon Park facility and MDS Prad is establishing a new plant on Prince Edward Island to treat compressor blades of gas turbine

engines. All these new developments are creating jobs and wealth on Prince Edward Island.

The Development and Technology Department will be spending an additional $500,000 in Community Development.

Madam Speaker, we were pleased to hear in the Federal Budget that a new National Research Council facility would be developed here, something we have supported for many years. Government has committed $500,000 to a new crown corporation for research and innovation to work with the new NRC facility, UPEI and others to create a bio-tech cluster of industries to add to the economy of Prince Edward Island.

"Government has committed $500,000 to a new crown corporation for research and innovation..."

The shell fishing industry has developed into a major sector on the Island. In the Budget, additional resources are committed to help the industry manage invasive species such as clubbed tunicate and oyster thief. Madam Speaker, as you are aware, our drinking water is of paramount importance to the people of our province. This Budget will continue to strengthen the Drinking Water Strategy to emphasize the importance we place on this vital resource. An additional $343,500 is provided for work on groundwater and surface water management.

"An additional $343,500 is provided for work on groundwater and surface water management."

The farming sector continues to be the mainstay of the provincial economy. The export of agricultural products in both raw and processed form dominates the Island's international earnings. We are committing $500,000 in 2003-2004 to the Future Farmer Program which provides interest relief on loans to new farmers purchasing or developing a farm unit. The National Green Cover Program will be supplemented in 2003-2004 by the provision of $250,000 toward the conversion of sensitive lands to alternative sustainable production called agroforestry.

Madam Speaker, as well, we are committing $442,500 to the Forest Environment Program. This encompasses a number of programs by engaging Islanders in tree planting and other activities to promote the environmental benefits of forests.

"... we are committing $442,500 to the Forest Environment Program."

Tourism has enjoyed unparalleled expansion since the opening of the Confederation Bridge. In the 2003-2004 Budget the Province is committing $17.6 million to Tourism PEI. The department intends to undertake several new marketing initiatives in the coming year. A new Internet tool will be developed to allow visitors to plan personalized vacation itineraries called "*Explore PEI*". In addition, $1.4 million is being committed to upgrading several Provincial Parks and Visitor Information Centres.

"... $1.4 million is being committed to upgrading several Provincial Parks and Visitor Information Centres."

Community Development

Madam Speaker, additional funds will be provided to support improvements in the delivery of family law services and access to justice for families involved in the family law system.

Madam Speaker, Team PEI returned from the Canada Winter Games this year after achieving the best showing ever. Our team brought back eight medals from Bathurst-Campbellton. In addition they were honored with the Jack Pelech Award for best sportsmanship, and Amanda Bulman received the prestigious President's Pin for assisting an injured cross country skier. Madam Speaker, on behalf of Government, I want to congratulate all who participated in the Games.

The marvelous showing of the Suzanne Gaudet rink at the recent Scott Tournament of Hearts also testifies to our young Islanders' achievements across Canada. We are very proud of you all.

In 2003-2004 the Department of Community and Cultural Affairs will receive $475,000 in New Initiative money for a Sports Strategy Implementation program. Funding is also provided to enable the PEI Special Olympics to host the Canadian Special Olympic Games in February 2004. Planning will also begin on the 2009 Canada Summer Games.

"...Department of Community and Cultural Affairs will receive $475,000 in New Initiative money for a Sports Strategy Implementation program."

Madam Speaker, additional funding was provided in the recent federal Budget for Strategic Infrastructure. The Province recently announced the support of sewage treatment and water distribution in Charlottetown, Summerside and Stratford under this program. This involves a provincial contribution of $15 million over five years. The Budget also includes $2.5 million for the Strategic Infrastructure Program.

"The Budget also includes $2.5 million for the Strategic Infrastructure Program."

Madam Speaker, during the past year the Province was active in supporting its communities. Under the Canada PEI Infrastructure program some $5,468,000 was disbursed to municipalities, on a cost shared basis with the Federal Government. We increased provincial support for municipalities under the local government equalization program. We assisted the PEI Sports Hall of Fame and the Confederation Centre of the Arts building renovations. We also contributed $2.5 million to the new Aquatic-Rink facility in the City of Charlottetown.

Madam Speaker, the Province made some drastic cuts to its capital budget in 2002-2003, in some measure to help pay for the Prince County Hospital. Unforeseen delays in construction of that project did permit some financial savings and the highway budget was consequently restored to some degree. Highway projects included improved access to the Queen Elizabeth Hospital and upgrades to several sections of Routes 2 and 4.

During the past year the Province extended the Waste Watch program province wide, making Prince Edward Island the national leader in sustainable waste management practice.

I am pleased to report that in 2003-2004 Transportation and Public Works capital spending is being restored. Compared to last year's budget we are committing an increase of $12 million to capital. This will include the reconstruction of the Pinette Bridge.

"I am pleased to report that in 2003-2004 Transportation and Public Works capital spending is being restored. "

Madam Speaker, I have highlighted some of the many measures being taken by Government in the service of Islanders. Details of the budgetary allotments will be provided by the Ministers of their specific portfolios.

Conclusion

The focus of this Budget Address has been the need for fiscal responsibility in the turbulent times that we are now in. The economy is performing well; our revenues reflect growth and it is most important that we continue with sensible responsible management. As in previous years we have taken a prudent approach in this Budget while maintaining public services and selectively investing in priority needs.

We know that our dependence on federal transfers is declining over time and this is in part because of the relative improvement in our economic self sufficiency. But federal transfers remain important to the Province. We look forward to improvements in this area in the coming year.

Madam Speaker, as Government we consider this budget undertaking as a responsibility and a privilege. We have been entrusted with the management of our finances, now in excess of $1 billion in support of the economic and social improvement of the Province. We feel this budget presents a level of prudence that is appropriate to our times and at the same time maintains our commitment to positive growth at a sustainable pace. We continue to be optimistic about our future, to partner with Islanders and their communities, and to build on the progress already achieved.

"We have been entrusted with the management of our finances, now in excess of $1 billion in support of the economic and social improvement of the Province."

I should like to offer my gratitude to the staff of the Provincial Treasury Department for their help and support in assisting me in the financial management of the Province.

Thank you

BUDGET SCHEDULES

1. Budget Summary

2. Gross Revenue

3. Gross Expenditure

4. Change in Consolidated Net Debt

5. Capital Revenue and Expenditure - Transportation & Public Works

6. Where the Money Comes From

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8. Summary of Budgeted Surplus (Deficit) of Crown Entities

9. Cash Requirements

10. Summary Comparison - Provincial Tax Rates

11. Federal and Provincial Personal Income Tax Rates

Schedule 1
Budget Summary

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
REVENUE			
Provincial Own Sources	610,225,100	608,007,900	591,307,600
Federal Sources	404,107,600	358,174,800	366,094,000
Sinking Fund Earnings	13,225,000	16,375,000	16,175,000
Operating Revenue	**1,027,557,700**	**982,557,700**	**973,576,600**
EXPENDITURE			
Program Expenditures	911,805,200	870,724,600	859,244,900
Interest Charges on Debt	105,408,600	100,900,000	106,500,000
Operating Expenditure	**1,017,213,800**	**971,624,600**	**965,744,900**
OPERATING FUND SURPLUS BEFORE NET CAPITAL EXPENDITURES	**10,343,900**	**10,933,100**	**7,831,700**
CAPITAL			
Capital Revenue	1,457,500	3,375,000	726,000
Capital Expenditures	34,750,000	42,400,000	37,381,000
Net Capital Expenditures	**33,292,500**	**39,025,000**	**36,655,000**
OPERATING FUND DEFICIT	**(22,948,600)**	**(28,091,900)**	**(28,823,300)**
CHANGES IN ACCOUNTING AND BUDGETARY POLICY			
Change in Tangible Capital Assets Policy	12,559,800	28,864,700	26,174,500
Net Deficit of Crown Entities	(1,103,200)	(8,809,800)	(10,048,300)
CONSOLIDATED DEFICIT	**(11,492,000)**	**(8,037,000)**	**(12,697,200)**

Schedule 2
Gross Revenue

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
PROVINCIAL OWN SOURCES			
Taxes	513,412,000	500,387,900	488,134,000
Investments	14,809,900	14,418,400	13,705,800
Fees and Services	29,218,600	40,270,400	38,392,800
Licenses and Permits	16,174,200	17,451,600	15,811,700
Sales	36,610,400	35,479,600	35,263,300
Sub-Total	**610,225,100**	**608,007,900**	**591,307,600**
GOVERNMENT OF CANADA			
Equalization	270,000,000	239,100,000	255,000,000
Canada Health and Social Transfer	104,700,000	93,721,000	89,086,000
Health Reform Funding	4,435,100	-	-
Diagnostic Equipment Funding	2,217,500	-	-
Canada Employment	4,552,000	6,322,000	3,552,000
Infrastructure Program Agreements	2,496,000	2,734,000	2,734,000
Young Offenders Services	2,243,600	2,292,600	2,292,600
Housing Programs	1,842,600	2,047,000	2,030,600
Minority and Second Language	1,709,000	2,009,000	2,009,000
French Services Agreement	1,280,500	1,551,000	1,403,000
Other	8,631,300	8,308,700	7,986,800
Sub-Total	**404,107,600**	**358,174,800**	**366,094,000**
TOTAL CURRENT REVENUE	**1,014,332,700**	**966,182,700**	**957,401,600**
Sinking Fund Earnings	13,225,000	16,375,000	16,175,000
TOTAL OPERATING REVENUE	**1,027,557,700**	**982,557,700**	**973,576,600**
Capital Revenue	1,457,500	3,375,000	726,000
GROSS REVENUE	**1,029,015,200**	**985,932,700**	**974,302,600**

Schedule 3
Gross Expenditure

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
CURRENT			
Agriculture and Forestry	31,941,900	29,325,400	29,960,100
P.E.I. Grain Elevators Corporation	165,000	165,000	165,000
Community and Cultural Affairs	22,160,200	20,124,600	20,104,100
Development and Technology	7,348,800	6,214,300	6,267,900
Prince Edward Island Business Development Inc.	28,427,100	32,551,000	30,022,000
Employment Development Agency	3,275,500	4,711,000	3,288,900
P.E.I. Energy Corporation	673,600	582,600	723,400
Education	216,537,600	207,403,500	202,273,700
Island Regulatory and Appeals Commission	1,065,100	1,065,100	1,065,100
Office of the Attorney General	32,025,100	30,569,900	29,739,800
Executive Council	3,025,300	3,082,600	3,160,300
Tourism	103,900	108,900	108,900
Tourism PEI	17,571,400	16,876,200	17,222,600
Health and Social Services	412,074,900	394,076,900	391,724,200
Legislative Assembly	3,317,500	3,131,800	3,101,800
Provincial Treasury	19,045,300	18,222,100	18,778,500
Council of Atlantic Premiers	173,500	183,700	183,700
General Government	8,779,900	4,224,600	5,174,600
Interministerial Women's Secretariat	299,800	300,300	299,700
P.E.I. Lending Agency	806,400	790,700	790,700
Technology Asset Management	2,228,000	1,876,400	1,576,400
Fisheries, Aquaculture and Environment	9,248,100	8,534,800	8,543,600
Transportation and Public Works	71,373,600	68,799,600	69,430,300
Auditor General	1,271,300	1,130,500	1,229,600
P.E.I. Public Service Commission	5,512,500	5,229,300	6,395,800
Employee Benefits	11,353,900	11,443,600	11,344,200
Workforce Adjustment	—	—	(3,750,000)
PROGRAM EXPENDITURE	**911,805,200**	**870,724,600**	**859,244,900**
Interest Charges on Debt	105,408,600	100,900,000	106,500,000
OPERATING EXPENDITURE	**1,017,213,800**	**971,624,600**	**965,744,900**
Capital Expenditures	28,250,000	24,400,000	16,381,000
East Prince Health Facility	6,500,000	18,000,000	21,000,000
CAPITAL EXPENDITURES	**34,750,000**	**42,400,000**	**37,381,000**
GROSS EXPENDITURE	**1,051,963,800**	**1,014,024,600**	**1,003,125,900**

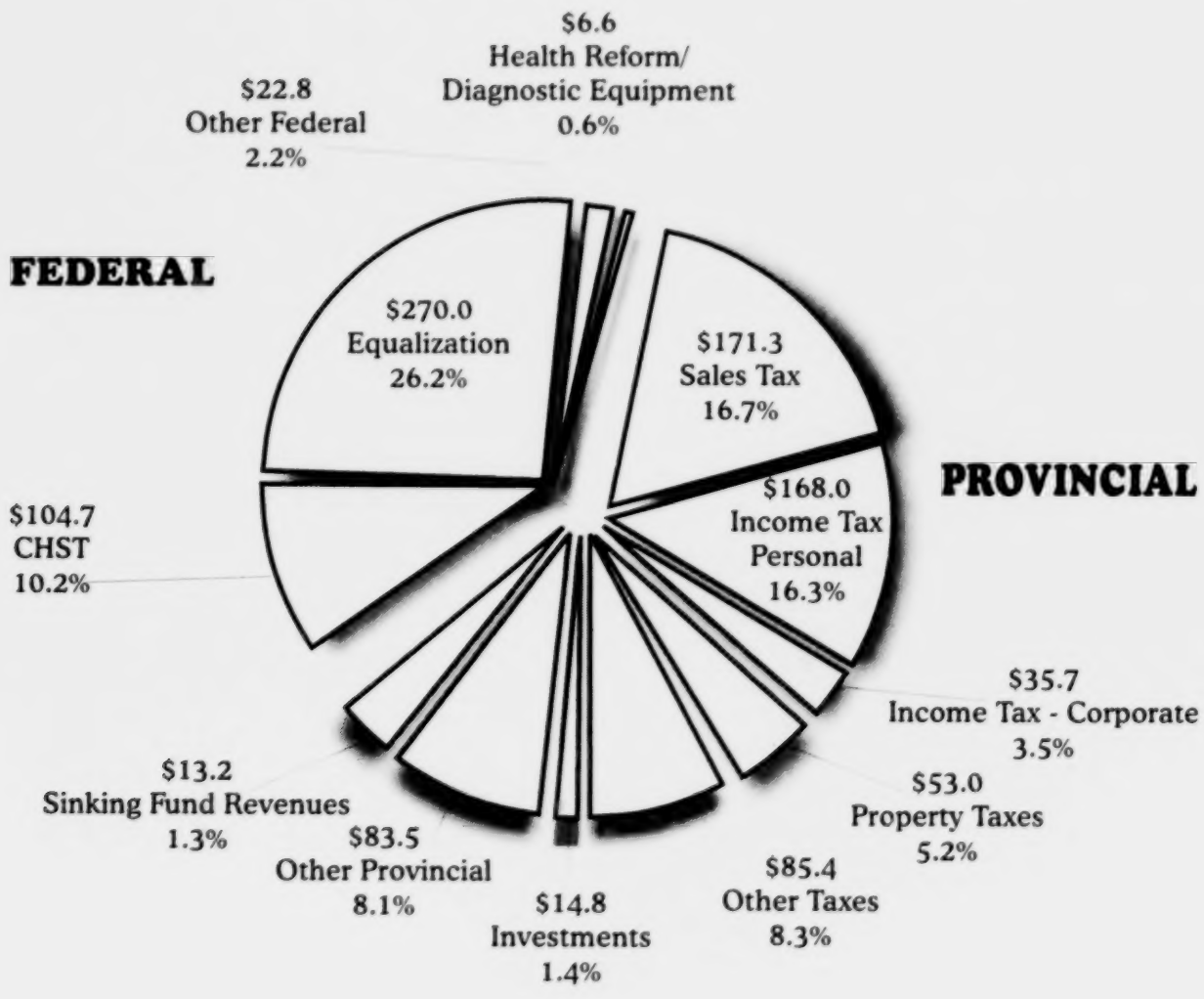
Schedule 4
Change in Consolidated Net Debt

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
NET DEBT AT BEGINNING OF YEAR	**1,129,970,800**	**1,082,069,100**	**1,082,069,100**
Acquisition of Tangible Capital Assets	38,002,100	52,216,000	49,361,800
Amortization of Tangible Capital Assets	(25,442,300)	(23,351,300)	(23,187,300)
Consolidated Deficit	11,492,000	8,037,000	12,697,200
Pension Adjustment (Net)	11,000,000	11,000,000	-
Change in Net Debt	35,051,800	47,901,700	38,871,700
NET DEBT AT END OF YEAR	**1,165,022,600**	**1,129,970,800**	**1,120,940,800**
SUMMARY OF ENDING NET DEBT			
Tangible Capital Assets at Beginning of Year	613,564,700	584,700,000	584,700,000
Acquisition of Tangible Capital Assets	38,002,100	52,216,000	49,361,800
Amortization of Tangible Capital Assets	(25,442,300)	(23,351,300)	(23,187,300)
Tangible Capital Assets at End of Year	**626,124,500**	**613,564,700**	**610,874,500**
Accumulated Deficit at Beginning of Year	516,406,100	497,369,100	497,369,100
Consolidated Deficit	11,492,000	8,037,000	12,697,200
Pension Adjustment (Net)	11,000,000	11,000,000	-
Accumulated Deficit at End of Year	**538,898,100**	**516,406,100**	**510,066,300**
NET DEBT AT END OF YEAR	**1,165,022,600**	**1,129,970,800**	**1,120,940,800**

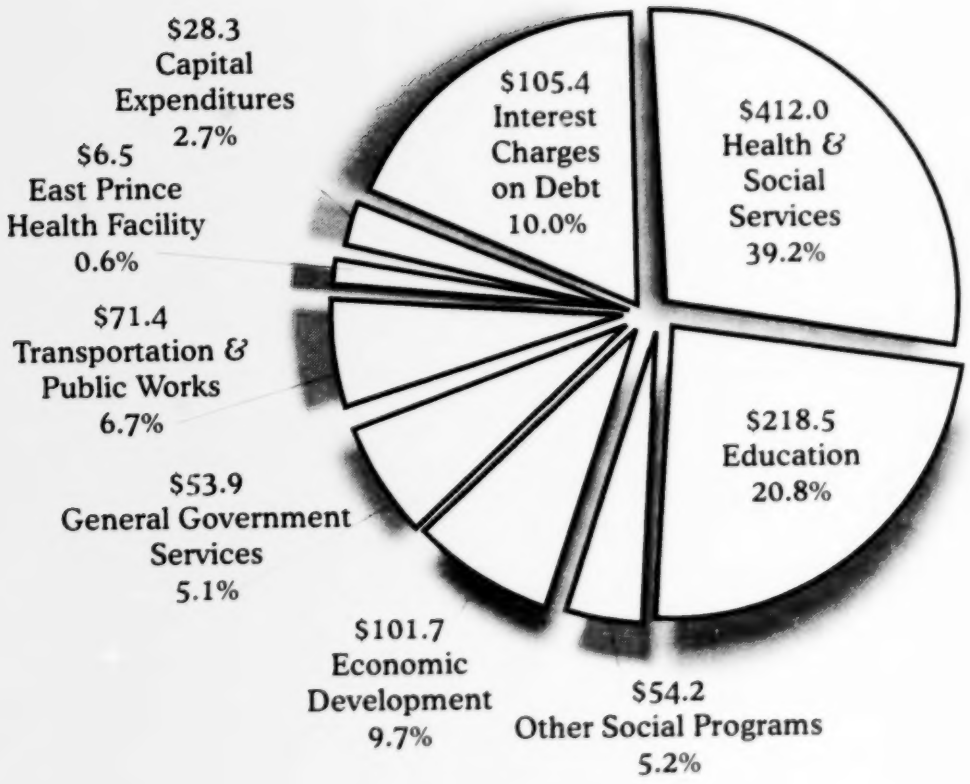
Schedule 5
Capital Revenue and Expenditure
Transportation and Public Works

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
REVENUE			
Land	270,000	350,000	146,000
Bridges	-	700,000	-
Federal Cost Shared Infrastructure Programs	1,007,500	1,715,000	-
Miscellaneous	180,000	610,000	580,000
Total Capital Revenue	**1,457,500**	**3,375,000**	**726,000**
EXPENDITURE			
Highways	25,323,000	21,411,000	14,000,000
Buildings	2,927,000	2,989,000	2,381,000
Total Capital Expenditure	**28,250,000**	**24,400,000**	**16,381,000**
NET CAPITAL EXPENDITURE	**26,792,500**	**21,025,000**	**15,655,000**

Schedule 6
Where the Money Comes From
2003-2004
($ millions)



Schedule 7
Where the Money Goes
2003-2004
($ millions)



Schedule 8
Summary of Budgeted Surplus (Deficit) of Crown Entities

	2003-04 Budget Estimate $	2002-03 Forecast $	2002-03 Budget Estimate $
Charlottetown Area Development Corporation[1]	10,500	4,200	172,200
Island Investment Development Inc.	-	-	-
Island Waste Management Corporation	(80,000)	90,000	939,000
P.E.I. Lending Agency	-	-	-
Prince Edward Island Energy Corporation	663,000	883,000	-
Prince Edward Island Grain Elevators Corporation	468,400	94,500	94,500
Prince Edward Island Liquor Control Commission	-	-	-
Prince Edward Island Lotteries Commission	-	-	-
Summerside Regional Development Corporation Ltd.[1]	(186,200)	(237,100)	(237,100)
NET SURPLUS OF GOVERNMENT BUSINESS ENTERPRISES	**875,700**	**834,600**	**968,600**
Agriculture Research Investment Fund Corporation	(337,300)	65,700	(134,300)
P.E.I. Aquaculture and Fisheries Research Initiative Inc.	(180,000)	(137,000)	(137,000)
P.E.I. Museum and Heritage Foundation	-	(16,000)	-
Prince Edward Island Agricultural Insurance Corporation	760,800	2,993,500	1,288,200
Prince Edward Island Business Development Inc.	(70,900)	413,900	-
Prince Edward Island Human Rights Commission.	(27,800)	(14,700)	-
Prince Edward Island Self Insurance and Risk Management Fund.	(215,600)	(49,100)	-
Prince Edward Island Special Projects Fund	(1,908,100)	(12,900,700)	(12,033,900)
NET DEFICIT OF CONSOLIDATED ENTITIES	**(1,978,900)**	**(9,644,400)**	**(11,017,000)**
NET DEFICIT OF CROWN ENTITIES	**(1,103,200)**	**(8,809,800)**	**(10,048,400)**

[1] Budget Estimates include 85% of the total surplus of the Charlottetown Area Development Corporation; and 75% of the total deficit of the Summerside Regional Development Corporation Ltd., to reflect the Province's ownership of these entities.

Schedule 9
Cash Requirements

	2003-04 Budget Estimate ('000 $)	2002-03 Forecast ('000 $)	2002-03 Budget Estimate ('000 $)
CASH REQUIREMENTS			
Budgetary Deficit of Operating Fund	22,949	28,092	28,800
Net Borrowings on behalf of Crown Corporations	21,210	12,010	62,300
Sinking Fund Earnings	13,225	16,375	16,200
Sinking Fund Provisions	12,924	11,698	11,700
Decrease in Special Projects Fund	1,970	13,006	-
Change in Short-term Payables/Receivables	400	16,900	1,000
Transfer to Pension Funds	18,000	18,000	18,000
Maturing Debt			
Canada Pension Plan	11,135	11,360	11,400
Refinancing of Canada Pension Plan	(11,135)	(11,360)	(11,400)
Public Debentures	39,461	52,451	48,900
Maturities Financed by Sinking Fund Proceeds	(35,665)	(48,934)	(48,900)
Provincial Deposit Receipts	-	26,000	15,000
TOTAL CASH REQUIREMENTS	**94,474**	**145,598**	**153,000**
SOURCES OF CASH			
Short-term Borrowing	14,474	45,598	53,000
Long-term Borrowing	80,000	100,000	100,000
TOTAL SOURCES OF CASH	**94,474**	**145,598**	**153,000**

Schedule 10
Summary Comparison - Provincial Tax Rates [1,2]

	Sales Tax (%)	Tobacco Tax ($/pk 25)	Fuel Tax		Corporate Tax	
			Gasoline (¢/litre)	Diesel (¢/litre)	General [3] (%)	Small (%)
British Columbia	7.5	4.00	14.5	15.0	13.5	4.5
Alberta	-	4.00	9.0	9.0	12.5	4.0 [5]
Saskatchewan	6.0	4.00 [4]	15.0	15.0	17.0	6.0
Manitoba	7.0	3.62 [4]	11.5	10.9	16.0	5.0
Ontario	8.0	2.15	14.7	14.3	12.5	5.5
Quebec	7.5	2.26	15.2 [4]	16.2 [4]	16.3	9.0
New Brunswick	8.0	2.93 [4]	14.5 [4]	16.9 [4]	13.0	3.0
Nova Scotia	8.0	3.25 [4]	15.5 [4]	15.4 [4]	16.0	5.0
Newfoundland	8.0	4.13 [4]	16.5 [4]	16.5 [4]	14.0	5.0
Prince Edward Island	10.0	3.74	14.0	13.5	16.0	7.5
Atlantic Average	8.5	3.51	15.1	15.6	14.8	5.1
National Average	7.8	3.41	14.0	14.3	14.7	5.5

1 For personal income tax rates and thresholds see Schedule 11.

2 P.E.I. rates are effective as of April 10.

3 Prince Edward Island, Newfoundland Ontario and Saskatchewan have special rates for manufacturers and processors.

4 Provincial Sales Tax applies.

5 Effective April 1, 2003.

Schedule 11
Federal and Provincial Personal Income Tax Rates, Thresholds and Surtaxes - 2003 [1]

	Tax Rates (%)	Thresholds	Surtax Rates (%)	Surtax Thresholds
Federal	16.0	$7,756 – 32,183		
	22.0	32,184 – 64,368		
	26.0	64,369 – 104,648		
	29.0	104,649 and over		
Newfoundland	10.57	$7,410 – 29,590	9	$7,032
	16.16	29,591 – 59,180		
	18.02	59,181 and over		
Prince Edward Island	**9.8**	**$7,412 – 30,754**	**10**	**$5,200**
	13.8	**30,755 – 61,509**		
	16.7	**61,510 and over**		
Nova Scotia	9.77	$7,231 – 29,590	10	$10,000
	14.95	29,591 – 59,180		
	16.67	59,181 and over		
New Brunswick	9.68	$7,756 – 32,183		
	14.82	32,184 – 64,368		
	16.52	64,369 - 104,648		
	17.84	104,649 and over		
Ontario	6.05	$7,817 – 32,435	20	$3,747
	9.15	32,436 – 64,871	36	4,727
	11.16	64,872 and over		
Manitoba	10.9	$7,634 – 30,544		
	14.9	30,545 – 65,000		
	17.4	65,001 and over		
Saskatchewan	11.0	$8,000 – 35,000		
	13.0	35,001– 100,000		
	15.0	100,001 and over		
Alberta	10.0	$13,525 and over		
British Columbia	6.05	$8,307 – 31,653		
	9.15	31,654 – 63,308		
	11.7	63,309 – 72,685		
	13.7	72,686 – 88,260		
	14.7	88,261 and over		

1 P.E.I. rates and thresholds are effective January 1, 2003; other provincial rates and thresholds as of April 2, 2003.

BUDGET PAPER A:

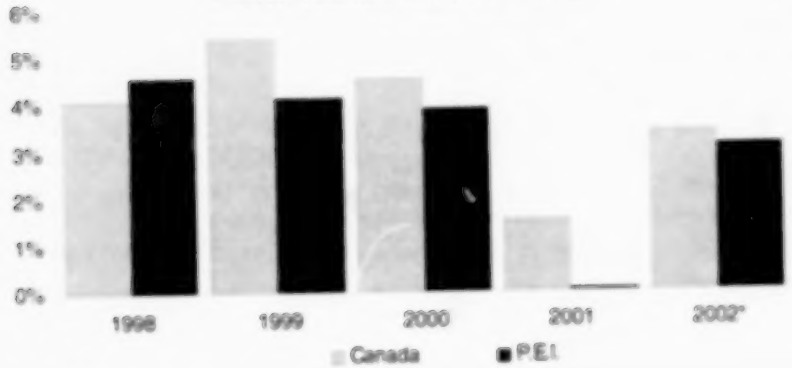
BACKGROUND NOTES ON THE ECONOMY

BUDGET PAPER A:
BACKGROUND NOTES ON THE ECONOMY

Introduction

In 2002 the Canadian economy outperformed all industrialized countries, posting a 3.4 per cent growth in real Gross Domestic Product (GDP). This was significantly better than had been anticipated a year ago, when growth of only 1.5 per cent was expected. Canada's resilience in the face of global uncertainties is attributed to strong domestic demand and effective monetary and fiscal measures. Prince Edward Island also performed better than expected in 2002.

Figure A.1
GROWTH IN GDP (in constant 1997 $)
CANADA and P.E.I., 1998-2002



Source: Statistics Canada, *Canadian Economic Observer*.
* Provincial Treasury forecast.

The provincial economy is estimated to have grown by 3.3 per cent in 2002, compared to the anticipated 1.2 per cent growth presented in the *2002 Budget Address*. Figure A.1 shows percentage gains in Canadian and provincial GDP since 1998. Statistics Canada estimates that P.E.I.'s economy experienced no growth in 2001, as a result of the impact of the drought on the potato harvest. The value of Prince Edward Island's GDP at market prices for 2002 is estimated to be $3,692 million. Growth in 2002 was highlighted by the recovery in potato production, growth in manufacturing, a buoyant residential construction sector and rising employment.

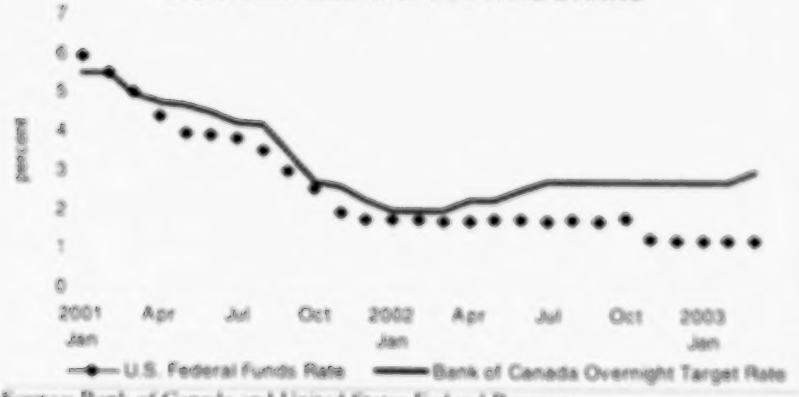
National and International Review

After contracting for three consecutive quarters in 2001, the U.S. economy showed signs of a slow recovery from the fourth quarter of 2001 through 2002. Estimates released by the *U.S. Bureau of Economic Analysis* indicate that the U.S. economy increased by 1.4 per cent in the fourth quarter of 2002 for an annual growth of 2.4 per cent, an improvement over the 0.3 per cent annual growth in 2001.

In contrast to the United States, the Canadian economy recovered strongly from the weak conditions in 2001, especially in the first half, when GDP increased by 5.1 per cent. Statistics Canada indicates that the national economy expanded by 3.4 per cent in 2002, up from the 1.5 per cent growth of 2001. Employment growth remained strong with 560,000 new jobs created. Low interest rates, together with sustained growth in labour income, resulted in strong consumer demand.

The *Organization for Economic Cooperation and Development* (OECD) estimates an average 1.5 per cent GDP growth among its members in 2002, while economic expansion in the *European Union* was limited to just 0.2 per cent in the last quarter of 2002, for an annual increase of 0.8 per cent.

Figure A.2
KEY INTEREST RATES OF
CANADIAN AND U.S. CENTRAL BANKS



Source: Bank of Canada and United States Federal Reserve.

Figure A.2 shows the key interest rates in Canada and the United States, from January 2001 to the present. Concern over a weak economy in the United States and declining stock market values caused the *U.S. Federal Reserve Bank* to progressively lower the federal funds rate through 2001 and again in November 2002, when it was lowered to 1.25 per cent. The Federal Reserve Bank left interest rates unchanged in March 2003, in light of global uncertainties.

By contrast, the Bank of Canada raised its target for the overnight lending rate in a series of steps: from 2 per cent in January 2002 to 2.25 per cent in April, 2.50 per cent in June, and 2.75 per cent in July 2002. The most recent increase in the Bank Rate, from 2.75 per cent to 3 per cent on March 4, 2003, signified the Bank's concern over inflationary pressures and an overheated economy.

The relatively low interest rates through 2002 reduced mortgage rates and the cost of consumer credit, which spurred new home construction. New automobile sales were also stimulated by attractive rebates and other incentives offered by manufacturers.

The number of new motor vehicles sold in Canada in 2002 increased by 8.5 per cent resulting in a record year for car sales. Housing starts in Canada rose to 205,034 units in 2002, up 26 per cent from 2001. However, non-residential investment fell from $48.1 billion in 2001 to $45.1 billion in 2002, a decline of 6.4 per cent. Overall government and business investment increased from $209 billion in 2001 to $214 billion in 2002, up by 2.5 per cent, compared to an increase of 1.7 per cent the previous year.

The Canadian exchange rate with the U.S. dollar hit a record low of 62.5 cents in January 2002, but by March 2003 the rate had climbed to 68 cents U.S.

Employment in Canada expanded by an average of 2.2 per cent during 2002 compared to 1.1 per cent a year earlier. The unemployment rate increased by a half percentage point to average 7.7 per cent.

Looking towards 2003, David Dodge, Governor of the Bank of Canada, stated on March 12, 2003:

> *"While we continue to foresee growth somewhat below potential in the first half of this year, we expect increased demand in the second half of 2003 and into 2004, as global uncertainties diminish. But with an appropriate reduction in the amount of monetary stimulus, we see the level of output remaining close to capacity* [3 per cent] *during this year and into 2004."*

Provincial Highlights 2002

- Based on available statistics for Prince Edward Island in 2002, the P.E.I. Department of the Provincial Treasury estimates that the economy grew by 3.3 per cent, as measured by constant dollar Gross Domestic Product. This compares with a national growth rate of 3.4 per cent. It is estimated that growth of 2 per cent will occur in 2003 on the assumption that international economic conditions do not deteriorate as a result of global unrest.

- Employment on Prince Edward Island expanded by 1.8 per cent in 2002 to average 67,100 persons. This is a slightly lower growth rate than in 2001, when Island employment increased by 2.2 per cent.

- Total labour income grew by 6.3 per cent to value $1,946 million in 2002, compared with national growth of 4.6 per cent.

- The value of international exports of goods was $679.1 million in 2002, an increase of 1.9 per cent from a year ago. International exports of frozen food products fell by 2.3 per cent, but this decrease was more than offset by a 20.1 per cent increase in the value of processed fish products and 57.2 per cent in the value of exports of raw potatoes.

- After a modest increase of 1.5 per cent in 2001, manufacturing shipments on Prince Edward Island bounced back strongly in 2002 with an increase of 9.5 per cent, to value $1,315.9 million. This was slightly lower than the average annual growth rate of 12 per cent that has been occurring since 1996.

- Total farm cash receipts recorded in 2002 improved by 9.5 per cent, to reach an all-time high of $369.6 million.

- Favourable weather conditions during the summer of 2002, following the disastrous 2001 season, resulted in a 57 per cent increase in the harvested potato crop with a volume estimated at 28,890,000 cwts. The estimated value of $194 million in potato receipts recorded in 2002 set a new record for Prince Edward Island.

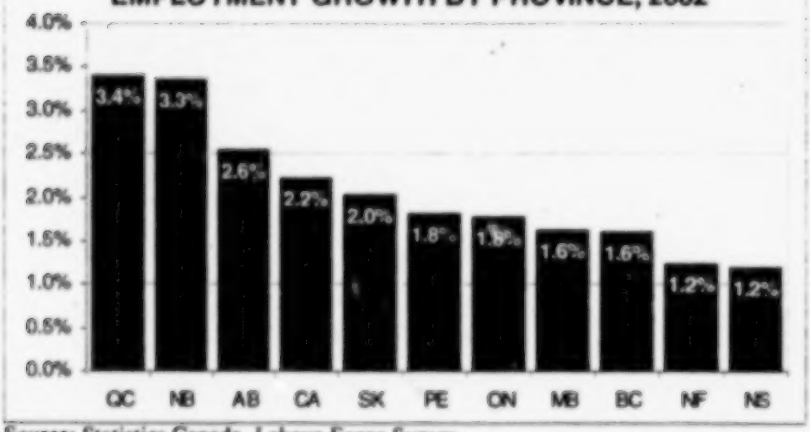
- Higher landings and strong prices increased the value of the 2002 lobster catch to an estimated all-time high of $105.5 million. However, preliminary estimates indicate that the value of all fish landings fell by 1.2 per cent in 2002 to value $162.9 million.

- According to the P.E.I. Department of Tourism, 413,559 parties visited Prince Edward Island in 2002, an increase of 1.5 per cent from 2001. They spent an estimated $353 million, an all-time high for Prince Edward Island.

The Prince Edward Island Economy

Employment

Figure A.3
EMPLOYMENT GROWTH BY PROVINCE, 2002

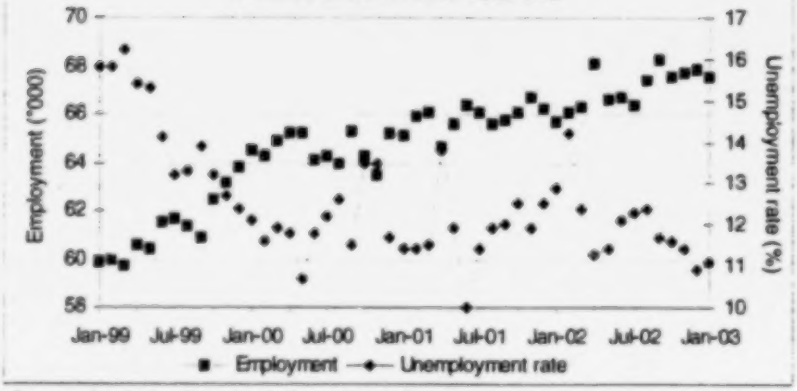


Source: Statistics Canada, *Labour Force Survey.*

Employment on P.E.I. rose to 67,100 in 2002, an increase of 1,200 from a year earlier. Figure A.3 shows employment growth in Canada and the provinces in 2002. One can see that P.E.I. had the second highest employment growth in the Atlantic region, at 1.8 per cent.

The unemployment rate averaged 12.1 per cent in 2002, slightly higher than the 11.9 per cent recorded a year earlier. This occurred largely because the labour force participation rate rose from 67.6 per cent in 2001 to 68.2 per cent in 2002. Figure A.4 illustrates monthly trends in unemployment and employment. It shows that the monthly unemployment rate on Prince Edward Island has been trending down since August 2002.

Figure A.4
EMPLOYMENT AND UNEMPLOYMENT RATE, PRINCE EDWARD ISLAND



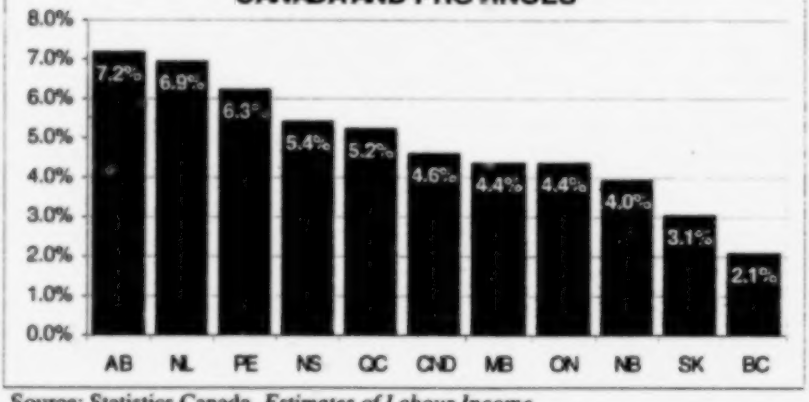
Source: Statistics Canada, *Labour Force Survey.*

Figure A.4 also shows the upward trend in employment since January 1999. Employment gains in 2002 were centred in the service-providing sector, accounting for 1,400 new jobs, with the business services and public administration sectors registering the largest increases.

Employment in the goods-producing sector fell by 200 jobs in 2002, mainly in the primary and construction sectors. The reduced level of employment in construction is related to the completion of several large projects in 2002, such as the Atlantic Technology Centre.

Personal Income

Figure A.5
TOTAL LABOUR INCOME GROWTH, 2002
CANADA AND PROVINCES



Source: Statistics Canada, *Estimates of Labour Income.*

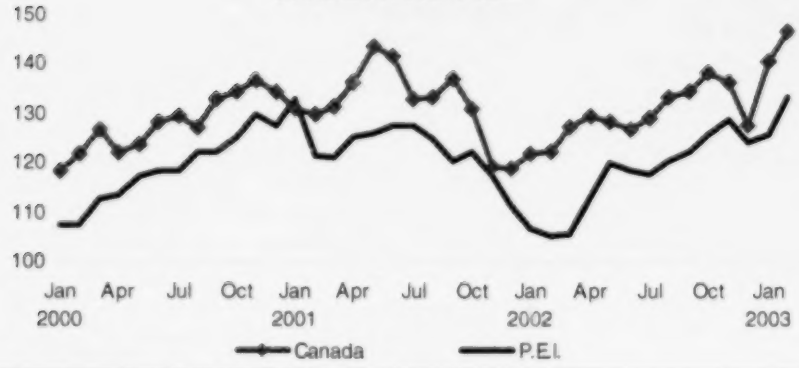
The P.E.I. Department of the Provincial Treasury estimates that personal income of Islanders rose from $3,141 million in 2001 to $3,299 million in 2002, an increase of 5 per cent. The major contributors to this growth were labour income and federal government transfers to persons. Total labour income improved by 6.3 per cent in 2002 as a result of employment gains and wage settlements and compares to a national growth rate of 4.6 per cent. Figure A.5 shows total labour income growth for Canada and the provinces in 2002. For the second year in a row, Prince Edward Island placed near the top with growth of 6.3%. This was led by manufacturing which expanded by 7 per cent.

Federal government transfer payments to persons are estimated to be 5.1 per cent higher in 2002 due to increases in Canada Child Tax Benefits (CCTB), Canada Pension Plan (CPP) benefits and Employment Insurance (EI) benefits. EI benefits paid on Prince Edward Island in 2002 totalled $196.7 million, an increase of 4.2 per cent from 2001. This increase is mainly attributed to a 15.5 per cent rise in the value of fishing benefits.

Negatively impacting growth in personal income in 2002 was interest, dividends and other investment income, which is estimated to have decreased by 7 per cent from 2001 as a result of poor financial market conditions. This was counteracted to some degree by net farm income, which is expected to increase significantly as a result of the recovery in the potato sector in 2002.

Consumer Prices

Figure A.6
ENERGY PRICE INDEXES (1992=100)
CANADA AND P.E.I.



Source: Statistics Canada, *Consumer Price Index*.

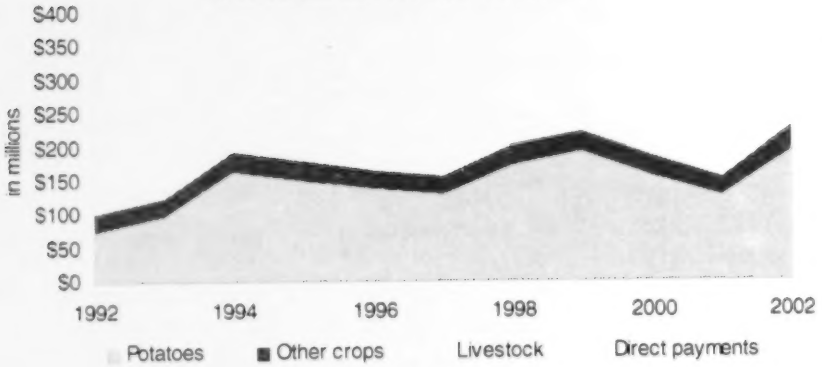
The All-Items Consumer Price Index for Prince Edward Island rose by 2.7 per cent in 2002, compared to 2.2 per cent nationally. Energy prices were on average 4.8 per cent lower in 2002. Figure A.6 shows the national and provincial energy price indexes from January 2000 to February 2003. Falling energy prices through 2001 reversed in 2002. Particularly noteworthy is the period March to November 2002, when energy prices rose by 22 per cent on Prince Edward Island compared to a 7 per cent increase nationally. Highest price increases for Islanders in 2002 were for motor vehicle insurance premiums, up 39 per cent, and cigarette prices, up 29 per cent.

Final Domestic Demand

It is estimated that real final domestic demand expanded by 4.3 per cent in 2002. The main contributors to this growth were the strong recovery in potato production, the surging residential construction sector, and growth in retail sales, especially motor vehicle sales. Preliminary estimates show that exports increased by only 3.8 per cent in 2002, while import buying rose by 6.4 per cent, explaining the 3.3 per cent growth in real GDP, by contrast with a 4.3 per cent growth in final domestic demand.

Agriculture

Figure A.7
ANNUAL FARM CASH RECEIPTS
PRINCE EDWARD ISLAND



Source: Statistics Canada. *Farm Cash Receipts.*

Total farm cash receipts for Prince Edward Island reached an all-time high of $369.6 million in 2002, an increase of 9.5 per cent from a year ago. Figure A.7 shows the major components that make up total farm cash receipts 1992 to 2002. The dominance of potatoes increased in this time, rising from 32 per cent of total farm cash receipts in 1992 to 53 per cent by 2002.

Table A.2 shows the recent trends in farm cash receipts by major commodity from 1997 to 2002. The increased potato production in 2002 is valued at $194.2 million, an increase of 54.1 per cent from 2001. However, total livestock receipts fell by 5.4 per cent in 2002 as hog and cattle receipts declined. Government support payments to farm operators declined by 60 per cent from 2001, when compensation payments relating to the potato diversion program and increased crop insurance pay-outs were at an all-time high.

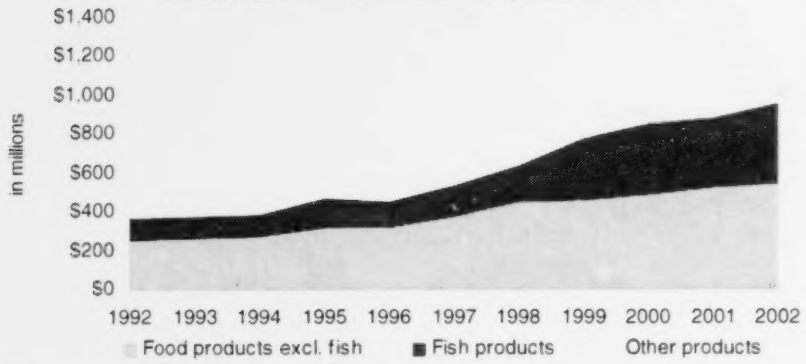
Table A.2.
Annual Farm Cash Receipts, ($ Millions)

Year	Total Crop	Potato	Total Livestock	Cattle	Hog	Dairy	Direct Payments	Total Receipts
1997	**155.7**	128.8	**116.9**	29.8	29.2	47.1	**8.0**	**280.6**
1998	**201.7**	173.3	**109.5**	28.8	20.6	49.5	**11.1**	**322.3**
1999	**222.2**	192.2	**106.1**	24.8	21.9	49.0	**18.7**	**347.0**
2000	**185.1**	154.5	**118.6**	26.8	29.5	51.0	**17.0**	**320.7**
2001	**153.6**	126.0	**125.2**	27.3	33.5	52.5	**58.5**	**337.4**
2002	**227.7**	194.2	**118.4**	25.8	27.6	53.3	**23.4**	**369.6**
Per Cent Change 2002/2001	**48.3%**	54.1%	**-5.4%**	-5.8%	-17.5%	1.6%	-60.0%	**9.5%**

Source: Statistics Canada. *Farm Cash Receipts*, cat no. 21-603-XPB

Manufacturing

Figure A.8
ANNUAL MANUFACTURING SHIPMENTS
PRINCE EDWARD ISLAND, 1992-2002



Source: Statistics Canada, *Monthly Survey of Manufacturers.*

In 2002 the value of total manufacturing shipments was $1,316 million, an increase of 9.6 per cent from 2001. Food shipments, excluding fish products, rose by 2.5 per cent to $539 million. Processed fish products, totalling $413.5 million, expanded by 16.2 per cent in value in 2002, while the value of all other manufacturing on Prince Edward Island increased by 14 per cent to reach $363.5 million. Figure A.8 shows the annual value of provincial manufacturing shipments between 1992 and 2002. Fish products have played an increasingly important role in Island manufacturing, expanding from $131.1 million in 1996 to $413.5 million in 2002. In comparison, the value of other food products increased by $223 million during that period, and the value of non-food manufactures rose by $132 million.

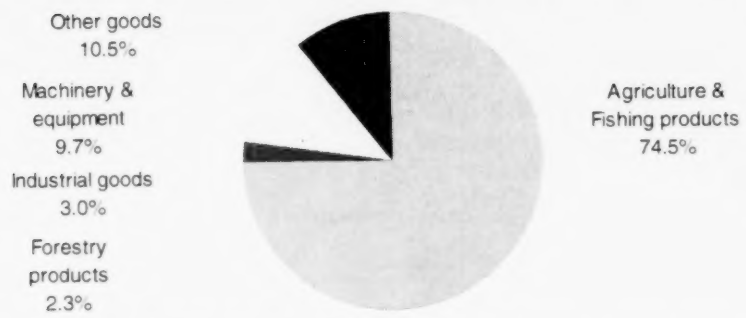
Fishing and Forestry

The P.E.I. Department of Fisheries, Aquaculture and Environment estimates that the total value of all fish landings on Prince Edward Island in 2002 was $163 million, a decrease of 1.2 per cent from a year ago. Preliminary estimates also indicate that lobster landings in 2002 reached a seven-year high of 19.9 million pounds, and that, combined with strong prices during the spring and fall seasons, the value of lobster landings reached a record-breaking $105.4 million that year. Snowcrab and bluefin tuna quotas increased in 2002, but herring landings declined by 21 per cent to 34 million lbs. due to quota reductions.

The P.E.I. Department of Agriculture and Forestry indicates that in 2002 most Island forest product sectors experienced slight production increases over 2001. Island lumber production is up 10 per cent and demand for fuel wood has been increasing in light of rising oil prices. The total volume of wood harvested on Prince Edward Island in 2002 is expected to increase slightly from the 2001 harvest. The Canada-U.S. softwood lumber dispute has not directly affected Island production, since Prince Edward Island is exempt from the countervailing duty imposed on the four major lumber-producing provinces - British Columbia, Alberta, Ontario and Quebec, where softwood is primarily harvested on Crown lands. Most Island softwood is harvested on private land with prices determined by market demand.

International Export Performance

Figure A.9
DISPOSITION OF EXPORTS OF GOODS
PRINCE EDWARD ISLAND, 2002

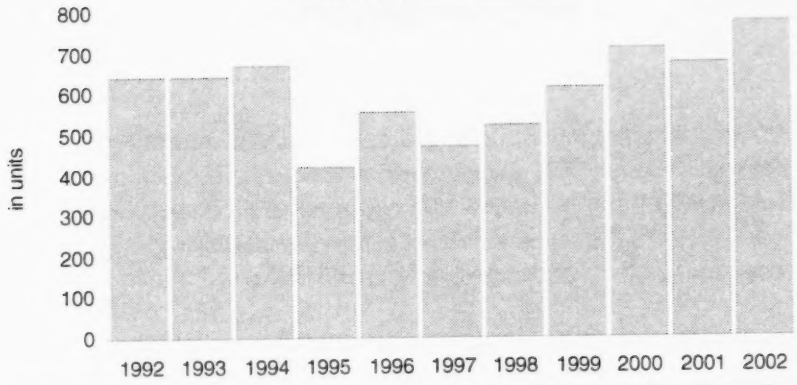


Source: Statistics Canada, *International Exports.*

After a 2.4 per cent decline in 2001, Prince Edward Island's export performance of goods in 2002 improved by 1.9 per cent and was valued at $679 million. Fresh and processed food products represent about 75 per cent of the province's value of international exports in 2002, as illustrated in Figure A.9. While the value of internationally exported frozen food products fell by 2.3 per cent in 2002, the value of fish and raw potato exports increased by 28.4 per cent.

Construction and Investment

Diagram A.10
HOUSING STARTS
PRINCE EDWARD ISLAND

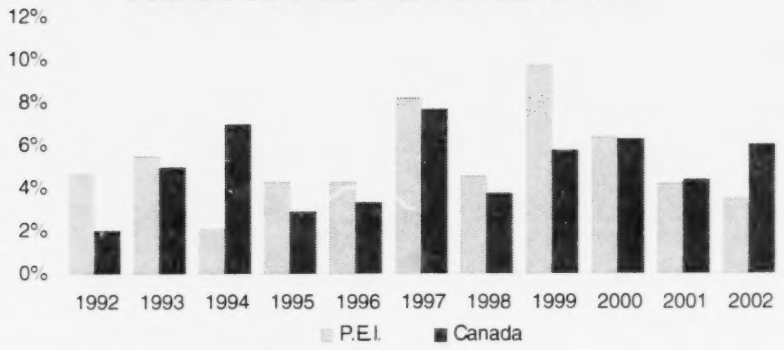


Source: Canada Mortgage and Housing Corporation.

Figure A.10 shows the total number of housing starts on Prince Edward Island between 1992 and 2002. As one can see, the province experienced strong growth in residential construction in 2002, when housing starts reached a thirteen-year high of 775 units, an increase of 15 per cent from 2001. In contrast, non-residential building permits in 2002 were valued at $47 million, 70 per cent below the record-breaking high of $152.9 million recorded in 2001.

Statistics Canada estimates the value of private and public investment for Prince Edward Island in 2003 to be $626.6 million, a decrease of 4 per cent compared to 2002. The value of construction is expected to fall by 7.6 per cent, while the value of investment in machinery and equipment is expected to increase by 1.5 per cent.

Figure A.11
RETAIL SALES GROWTH, 1992-2002
PRINCE EDWARD ISLAND AND CANADA



Source: Statistics Canada, Retail Sales.

Retail Trade

Figure A.11 illustrates growth in retail sales on Prince Edward Island and in Canada from 1992 to 2002. In only three years did the nation's growth rate exceed that of P.E.I. Provincial retail sales expanded by 4.2 per cent in 2001 and 3.4 per cent in 2002. This compares to a national growth rate of 4.4 and 6 per cent, respectively. Total retail sales on Prince Edward Island were valued at $1,325 million in 2002.

The number of new motor vehicles sold on Prince Edward Island totalled 4,996 in 2002, an increase of 7.8 per cent from 2001 compared to a 5.4 per cent decline in 2001. This represents a value of $131.2 million, up 8.7 per cent from 2001.

Tourism

The P.E.I. Department of Tourism estimates that 387,154 pleasure parties came to Prince Edward Island in 2002, about 2 per cent more than in 2001. The number of business parties fell from 27,481 in 2001 to 26,405 in 2002, a decline of 3.9 per cent. In 2002, the number of pleasure parties from the United States increased by 4 per cent from 2001, while 1.5 per cent more Canadian pleasure parties came to the province. Total spending by all visitors between May and October 2002 is estimated at $353 million.

Government

Government services include public administration, education, health and social services and account for almost 30 per cent of Prince Edward Island's economic activity. The government service sector in total employs more Islanders than any other sector in the province.

According to Statistics Canada's *Survey of Employment, Earnings and Hours* (SEPH), employment in public administration (federal, provincial and municipal) decreased by 2.6 per cent in 2002, which translates into a loss of 168 positions. The survey shows that education services experienced job growth of 2.7 per cent in 2002, while the health and social services sector including private services, experienced virtually no job growth.

Provincial tax revenues increased to $459.7 million in FY 2001/02 which is a 4.1 per cent improvement from FY 2000/01. Federal transfers to Prince Edward Island (Equalization and Canada Health and Social Transfer (CHST) payments) contributed 37 per cent to the province's total revenue. Equalization payments increased by 4.4 per cent from 2001, to value $282.3 million, while CHST payments advanced 15.9 per cent to total $88.9 million.

Total provincial government spending rose to $1.03 billion in FY 2001/02, an increase of 3.7 per cent from FY 2000/01. The budget of the Department of Health and Social Services was 9.3 per cent higher in FY 2001/02, while the Department of Education experienced a budgetary increase of 4.5 per cent.

Summary and Outlook for 2003

The Bank of Canada, in its *Monetary Policy Report Update: January 2003*, estimates that economic growth for Canada in 2003 will be close to its potential of 3 per cent. This is slightly below the rate indicated in its October Report, largely as a result of the slower growth prospects for the U.S. and overseas economies. Nonetheless, the Bank anticipates increased demand pressures in the second half of 2003 and into 2004, following growth at slightly below potential in the first half.

The Bank of Canada may notch interest rates up again in the coming months, according to the Governor of the Bank of Canada. However, major uncertainty over the Iraq situation makes economic forecasts at the present difficult.

The P.E.I. Department of the Provincial Treasury estimates that the value of Gross Domestic Product on Prince Edward Island was $3,692 million in 2002, an increase of 3.3 per cent in constant dollars. The pace of economic expansion in 2002, after no growth in 2001, was at par with the average annual rate of expansion per cent since 1997. Economic growth in 2002 was led by record-breaking potato receipts, a buoyant residential construction sector, strong manufacturing and employment gains in the service-providing sector.

The Provincial Treasury estimates that the Prince Edward Island economy will expand in the order of 2 per cent in 2003. The goods-producing sector is expected to grow by 1.4 per cent, while the service-providing sector is forecast to increase by 2.1 per cent.

SUMMARY STATISTICS
PRINCE EDWARD ISLAND ECONOMY

	1996	1997	1998	1999	2000	2001	2002
Population on 1 July (in '000s)	136.2	136.9	136.9	137.8*	138.3*	138.9*	139.9
Personal Income per capita ($)	18,926	19,197	19,861	20,667*	21,971*	22,597*	23,578[1]
As % of Canadian Personal Income	*81.7*	*80.5*	*80.3*	*80.4*	*80.6*	*80.5*	*82.2*[1]
Employment (in '000s)	58.9	59.2	60.4	61.3	64.5	65.9	67.1
Unemployment rate (%)	14.7	15.4	13.8	14.4	12.0	11.9	12.1
Unemployment Rate - Canada	*9.6*	*9.1*	*8.3*	*7.6*	*6.8*	*7.2*	*7.7*
CPI - annual change P.E.I. (%)	1.8	1.2	-0.5	1.2	4.1	2.6	2.7
CPI - annual change (%) Canada	*1.6*	*1.6*	*0.9*	*1.7*	*2.7*	*2.6*	*2.2*
Retail trade ($ millions)	931.7	1,007.9	1,053.7	1,156.6	1,230.1	1,281.3*	1,324.8
New Motor Vehicle Sales (units)	4,120	4,717	4,556	4,802	4,902	4,635	4,996
Farm Cash Receipts ($ millions)	291.3	280.6	322.3	347.0	320.7*	337.4*	369.6
Potato Receipts ($millions)	137.5	128.8	173.3	192.2	154.5*	126.0	194.2
Lobster Landings ($ millions) *	61.3	73.2	80.6	88.9	87.8	104.8	105.4
*Lobster Landings (lbs - millions) **	*17.9*	*17.8*	*18.9*	*18.5*	*19.1*	*19.4*	*19.9*
Housing Starts (units)	554	470	524	616	710	675	775
Investment ($ millions)	482.0	467.8	481.3	547.5	549.3	597.4*	652.4
Manufact. shipments ($ millions)	678.8	788.8	937.6	1,109.0	1,183.1	1,201.3*	1,315.9
Tourist expenditures ($ millions)[2]	160.1	245.9	274.4	283.4	280.0	310.0	331.8
International exports ($ millions)	353.7	435.2	466.0	566.5	682.9	666.4*	679.1
GDP at market prices ($ millions) *	2,823	2,800	2,981	3,173	3,394	3,480	3,692[1]

* revised data

Note 1: Provincial Treasury estimate
Note 2: Expenditures do not include business travel

Sources: Statistics Canada; CMHC; Provincial Department of Fisheries, Aquaculture and Environment; Tourism P.E.I.

BUDGET PAPER B:

FEDERAL FISCAL ISSUES

BUDGET PAPER B:
FEDERAL FISCAL ISSUES

" Madam Speaker, discussions concerning health care dominated federal provincial meetings this winter."

Hon. Patricia J. Mella - April 10, 2003

Budget Paper B provides background material on federal provincial discussions related to the Equalization and Canada Health and Social Transfer programs. These two federal programs form 95 per cent of the value of federal transfers to the Government of Prince Edward Island, involving in the order of $350 million. They are also the source of much controversy between the federal and provincial governments.

The paper is divided into four parts: 1. The 2003 First Ministers "Health Accord": 2. Equalization discussions: 3. Implications of the 2001 Census results: and 4.The resolution of the federal misallocation of Provincial Income Tax revenues.

1. The 2003 First Ministers "Health Accord"

Premiers met with the Prime Minister on February 4-5, 2003 to negotiate improved health funding arrangements for Canada. The 2003 "Health Accord" that resulted fell far short of provincial and territorial needs and is not viewed as a federal provincial agreement by the Province of Prince Edward Island. The terms of the "accord" were set out by the Federal Government without provincial endorsement.

The discussions were the culmination of several meetings by Health Ministers, Premiers and Finance Ministers prior to and following the submission of the report by Roy Romanow, the *Royal Commission on the Future of Health Care in Canada*, to Parliament on November 28, 2002.

Provincial and Territorial Ministers of Finance met with John Manley, the Federal Minister of Finance, December 17-18 2002, to express their views on the need for significant improvements in federal funding of health care in Canada. The Romanow Report proposed sweeping changes to ensure the long term sustainability of Canada's health care system. His recommendations were to add approximately $15 billion to federal payments to provinces over the coming three years, through increased funding of $3.5 Billion in 2003-04 rising to $6.5 billion in 2005-06. Federal funding in the first three years was to be targeted to Health Reform in selected areas. In addition the report recommended that a Canada Health Transfer be carved out of the Canada Health and Social Transfer.

Provinces expressed the need for flexibility in dealing with the issue of health reform, and reiterated the need to raise federal funding to at least 18% of provincial expenditures on Health, Education and

Social Services, through the CHST. This was the 1994-95 level of federal support, prior to the cuts that were made in 1996 and 1997. Increased federal support of an estimated $24.7 billion in the years 2002-03 to 2005-06 was called for by Provincial Finance Ministers.

Provincial and Territorial Premiers met January 23 2003, when they endorsed the call for restoration of CHST to at least 18% of total health and social expenditures in 2002-03, with increasing financial support in the coming years. They proposed that federal support be stepped up to 25% by the end of the decade. As part of the improved federal support for Health care they also called on the Federal Government to remove the equalization ceiling and to strengthen the Equalization program formula. They also agreed with Romanow that to ensure greater accountability, a Canada Health Transfer be created to replace the CHST.

Following the First Ministers meeting on February 4-5, 2003, the terms of the federal package were then incorporated into the Federal 2003 Budget that was presented on February 18, 2003.

Federal descriptions of the Health package exaggerate new funding as they combine previous commitments to increase CHST, made in September 2000 and budgeted in 2001, with the new funding. The following table separates new funding from pre-existing commitments.

Table B.1 Components of Increased Federal Provincial Transfers

	Pre 2003 CHST	Additional CHST/CHT	Health Reform	Medical Equipment	Total Transfer	Transfer Increase
Notes	Previous agreement extended only to 2005-06.	First three years paid as $2.5 billion Trust from 2002-03.	$16 billion After 2008 move into the CHT.	To be paid as $1.5 billion Trust from 2002-03.		Further $2 billion to be paid in 2003-04 if available.
Year			$ Billions			
2002-03	19.1				19.1	0.0
2003-04	19.8	1.0	1.0	0.5	22.3	2.5
2004-05	20.4	1.0	1.5	0.5	23.4	3.0
2005-06	21.0	0.5	3.5	0.5	25.5	4.5
2006-07	21.0	0.6	4.5		26.1	5.1
2007-08	21.0	1.2	5.5		27.7	6.7
2008-09	21.0	7.9			28.9	7.9
2009-10	21.0	9.2			30.2	9.2
2010-11	21.0	10.5			31.5	10.5

Source: Federal Budget 2003.

The 2003 Health Accord package consists of the following components: a specific Canada Health Reform Fund to provide $16 billion to provinces in new funds over 5 years targeted to primary health care, home care and catastrophic drug coverage; a supplement to CHST of $2.5 billion; a Diagnostic/Medical Equipment Fund of $1.5 billion to improve access to diagnostic services; improved CHST funding after 2005-06, of $1.8 billion; and a possible increase of $2 billion to CHST at the end of 2003-04, depending on the federal fiscal position. In addition to these additional federal-provincial funds the Health Accord includes $600 million for electronic patient records, $500 million for research hospitals, increases for First Nations Health, EI compassionate care, and other federal priorities.

The Federal Government intends to split the CHST into a Canada Health Transfer (CHT) and Canada Social Transfer (CST) by April 2004. The Budget indicates that sixty two per cent of the CHST will go to the CHT. Subject to a review of progress in achieving the agreed upon reforms, effective April 1, 2008, the CHT would also receive the Health Reform funds from 2008-09.

The new $16 billion of Canada Health Reform funding is to allow provinces to accelerate reforms in primary health care services, home care services and catastrophic drug coverage in the next five years. Provinces will prepare annual public reports on their progress in meeting these Health Reform priorities commencing in 2004, though each province will have the flexibility to determine how best to achieve the reform objectives.

The additional dollars being committed to provinces, as shown in Table B.1, sum to $10 billion over the next three years. This can be compared to the $24.7 billion that Finance Ministers agreed was needed. It might also be compared to the $15 billion that Romanow recommended.

Federal statements in the Budget that Health funding was increased by $17.3 billion are misleading as they include $3.9 billion that was previously committed in 2001. Also, $3.4 billion is made up of commitments to First Nations Health, Health Information technology and other direct federal programs, leaving $10 billion for provinces over three years.

Of the total package of improved Health transfers, $5.1 billion will be charged against the federal surplus in 2002-03, by using Trust Funds. Also, $1 billion of the pre 2003 CHST transfers for 2002-03 and 2003-04, that are shown in Table B.1, was actually expensed by the Federal Government in 1999-00, through the creation of Trust funds that year.

Bearing this in mind, the overall expenditure impact of the federal measures in the Health package, as indicated in the 2003 Federal Budget documents, is only $1 billion of additional spending in 2003-04. Not included in this is an amount, up to $2 billion, that the Federal Government agreed to add to the CHST, if the federal Minister of Finance determines in January 2004 that there is a sufficient surplus above the normal contingency reserve for the 2003-04 year.

An additional aspect of the 2003 "Health Accord" was a statement by the Federal Government reaffirming the importance of the Equalization program, and to permanently remove the ceiling from the formula on a "going-forward basis". That is described more fully in the following section, but it was made clear in the federal Budget that its removal would not apply to years where the ceiling is presently in effect.

Impacts on Prince Edward Island

The overall financial impact of the "Health Accord" is not fully determined as the utilization of the Health Reform Fund is contingent on the development of specific objectives in the three target areas, and the establishment of provincial programs to meet those targets.

The federal Budget documents state that the various additional health funds for provinces will be shared on an equal per capita basis. As the Province's share of the Canadian population in the years to come can vary, so any estimate of the provincial impact of the "Accord" is prone to some error. This problem is particularly acute as at present population estimates are subject to significant revision in 2003 to correct for the 2001 Census results. A discussion of the population revisions appears later in this Paper. Bearing this in mind, the estimates in the following table have been made with an allowance for the probable impact of these revisions.

Table B.2 Estimates of Federal Provincial Transfers to Prince Edward Island

Year	Pre 2003 CHST	CHST Supplement & Addition.	Health Reform	Diagnostic Medical Equipment	Total Transfers	Total Additional Transfers
			$ Millions			
2002-03	90.6				90.6	0
2003-04	93.7	11.0	4.4	2.2	111.3	17.6
2004-05	96.4	8.8	6.6	2.2	114.0	17.6
2005-06	99.0	0	15.3	2.2	116.5	17.5
2006-07	99.0	2.6	19.6	0	121.2	22.2
2007-08	99.0	5.2	23.8	0	128.0	29.0
5 year total		27.6	69.7	6.6		103.9

Source: Federal Budget 2003, Provincial Treasury Calculations

The overall increase in federal transfers to Prince Edward Island under the Health Accord, over the next five years sums to $103.9 million. Of that amount, $27.6 million will be available as new CHST funding and $6.6 million through the Diagnostic and Medical Equipment Fund. The major part of the new funds takes the form of the Health Reform fund, at $69.7 million.

The Health Reform money grows from $4.4 million in 2003-04 to $23.8 million in 2007-08. This money is to be used for the acceleration in development of Primary Care, Home Care and Catastrophic Drug coverage services by the Province, as called for in the Accord. The Province's use of the $6.6 million in the Diagnostic and Equipment Fund is tied to the support of specialized training and equipment to improve access to publicly funded diagnostic services.

In 2008-09 the Health Reform Fund is to be transferred to the Canada Health Transfer, which will also receive 62% of the CHST in that year, according to federal documents. That arrangement remains subject to further federal provincial discussions, and depends on success in meeting the objectives in the Health Reform targets.

Additional funding through the CHST Supplement is $11 million in 2003-04 and $8.8 million in 2004-05, and so on, totaling $27.6 million. This takes into account the receipt of the Province's share of the $2.5 billion supplement in 2003-04, and the additional contingent amount in 2004-05. These transfers represent unconditional transfers to the Province for the general purpose of supporting health, post secondary education and social services.

The provincial costs of delivering these services have been increasing, on average, at a rate of $25.5 million per year (over the last five years). This means that, after 2003-04 the CHST transfer will again represent a falling percentage of provincial costs for health care, post secondary education and social services.

An additional amount was added to the CHST on March 13, 2003 as a result of an agreement between Federal, Provincial and Territorial Ministers responsible for Social Services, for Early Childhood Development programs and services. This addition was $25 million in 2003-04 nationally, rising to $75 million in 2004-05, $150 million in year three and so on, to total $900 million over five years. For Prince Edward Island this adds $110,000 to CHST in 2003-04, $330,000 in 2004-05, and $660,000 in 2005-06. Budgeted amounts for CHST include these additions.

2. The Equalization Program

Equalization is easily the Government of Prince Edward Island's largest source of revenue valuing some $239 million in 2002-03. Equalization enables the less prosperous provincial governments to provide their residents with public services that are reasonably comparable to those in other provinces, at reasonably comparable levels of taxation as described in 36(2) of the Canadian Constitution.

> ***36. (2) Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.***

Equalization Entitlements are calculated annually according to a formula set out in federal legislation and regulations. Provinces with revenue raising ability, or fiscal capacity below a threshold or standard amount receive an Entitlement from the Federal Government to bring their revenues up to that standard.

How Equalization is Calculated

The present Equalization standard measures the average fiscal capacity of the five 'middle income' provinces – Quebec, Ontario, Manitoba, Saskatchewan and British Columbia. The calculation is made on the basis of annual Entitlements that reflect economic data and provincial revenues. For any given Entitlement there are eight estimates made over a period of several years. The final estimate thus occurs three and a half years after the first estimate for that year is made. These revisions take the form of prior year adjustments and can be very large.

The concept of fiscal capacity is critical to the understanding of how the equalization program functions. Fiscal capacity measures how much revenue a province *could* raise from its own tax sources using a definition of tax bases and tax rates that are common to all provinces. This is accomplished by basing the formula on the "representative tax system" or RTS. The total fiscal capacity of a province is a measure of its ability to raise revenues from 33 revenue sources – including personal income tax, corporate income tax, sales taxes, property tax, and other sources – using a national average tax rate for each tax base. This ensures that no individual province can manipulate the program through its own tax practices.

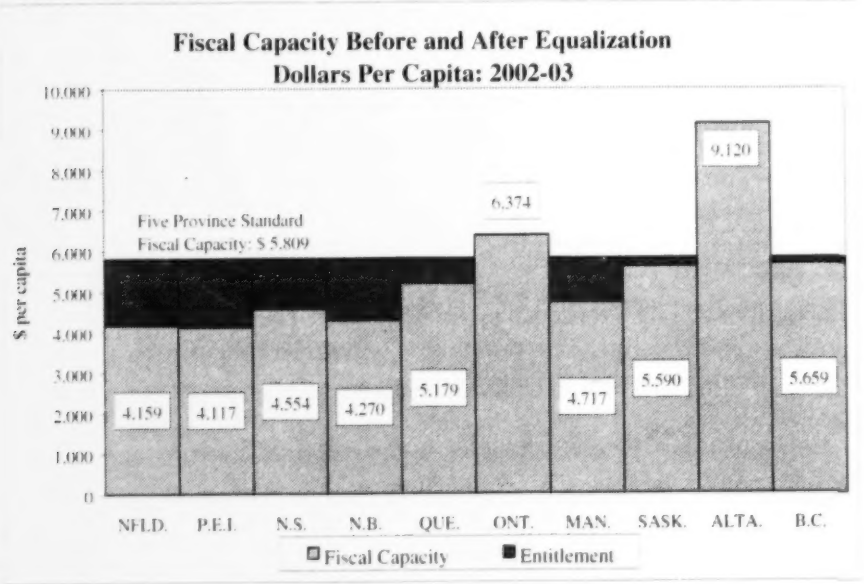
Consider an example using personal income taxes. The formula for 2002-03 estimates that on average the five provinces in the standard could raise $1,543 per capita from their personal income tax at the national average tax rate. The equivalent calculation for Prince Edward Island, using our own income tax base and the national average tax rate, generates a figure of $900 per capita. Thus Prince Edward Island has a per capita deficiency of $643 in personal income tax in 2002-03 relative to the standard amount. Multiply this number by our population and one gets $89.9 million, which is our deficiency for the personal income tax base. The Federal Government pays Prince Edward Island that amount to offset the revenue deficiency for that tax source.

The same basic calculation is performed for each of the 33 tax bases in the formula. Summing all of the tax bases yields the Province's total Entitlement. Provinces with a total Entitlement that is positive receive that amount in compensation, while provinces with a negative total, do not receive an Entitlement. The Equalization program only raises fiscal capacity.

Figure B.1 shows the per capita fiscal capacity of each province for 2002-03 relative to the five province standard for all 33 tax bases. One can see that provincial per capita fiscal capacity, represented by the lightly shaded portion of the chart, ranged from $4,117 for Prince Edward Island to $9,120 for Alberta in that year. Provinces with a fiscal capacity below the standard amount of $5,809 per capita for that year receive an Entitlement to bring them up to the standard. For Prince Edward Island the difference between our fiscal capacity and that of the standard was $1,692 per

capita. This was our per capita Entitlement for that year and is represented by the darker shaded portion of the chart. After Equalization, all receiving provinces have a fiscal capacity of $5,809 per capita while Ontario and Alberta remain at their higher levels.

Figure B.1



Equalization payments are unconditional, so receiving provinces are free to spend the funds on public services according to their own priorities. Currently, eight of the ten provinces qualify. These are Newfoundland and Labrador, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Manitoba, Saskatchewan and British Columbia. In 2002-03, provinces received approximately $10.3 billion in Equalization payments from the Federal Government under this formula.

The three territories also receive federal fiscal transfers from the Federal Government through a different program, the Territorial Formula Financing program. This amounted to approximately $1.3 billion in 2002-03.

Equalization Renewal

The Equalization program is throughly reviewed by the Federal Government in consultation with provinces and territories every five years in order to renew the program. The current program expires March 31st, 2004, so this is a critical year in the renewal process. The renewal process ensures that the provinces and the Federal Government have the opportunity to assess the program's effectiveness at accomplishing its objectives as stated in the Constitution.

Staff from the Economics, Statistics and Federal Fiscal Relations Division of Provincial Treasury play an active role in representing the Province at these negotiations and also provide technical input

and advice to the Minister at Ministerial discussions on the program. The Division has taken the lead on a number of initiatives in the renewal discussions by presenting several technical papers and hosting meetings to aid these discussions. In the fall of 2002, the Province also co-hosted an international conference with the Forum of Federations, on federal fiscal relations and economic development, at which senior government officials and academics from 5 continents came to discuss their country's experience with Equalization. Each country's Equalization program is unique, reflecting each country's different history, social and political circumstances. It was also apparent that the role of the Canadian program in reducing fiscal disparities is much greater than in many other federations.

It is the concern of the Government of Prince Edward Island that fiscal disparities are growing among Canadian provinces. While Equalization reduces these differences, large disparities remain even after provinces are Equalized. In 2002-03 the gap between receiving provinces and the wealthiest province was $3,311 per capita after Equalization, compared to $2,223 four years earlier. These fiscal disparities among the Canadian provinces have become a serious concern for receiving provinces and their ability to maintain reasonably comparable services at reasonably comparable levels of taxation for their citizens.

It is for this reason that provinces have called on the Federal Government, on many occasions, to strengthen the program. The following is a discussion of three key renewal issues.

Equalization Ceiling

The Ceiling on the Equalization program was introduced in 1982 to offer the Federal Government protection from potential rapid and unsustainable year over year growth in total Entitlements. The Ceiling is triggered when the cumulative growth in total Entitlements exceeds the rate of growth in GDP from a base year. When the ceiling is triggered, receiving provinces have their Entitlement clawed back on an equal per capita basis.

At the First Ministers' meeting in February 2003 the Prime Minister announced that the government would permanently remove the Equalization ceiling on a "going-forward basis". The Federal Government has interpreted this to mean that the ceiling would be removed for the fiscal year 2002-03 and future years. However, the ceiling presently imposed on 2000-01 and 2001-02 remains in place. Current Equalization payments are still impacted by the ceiling application because the Entitlements for those years have yet to be finalized.

The total impact of the 2000-01 Ceiling on provincial Entitlements are shown in Table B.3. As the table shows, the impact of not removing the Ceiling for 2000-01 and 2001-02 reduces Prince Edward Island's Entitlements by $4.9 million. The total cost to provinces is $320 million. For Newfoundland and Labrador, Prince Edward Island, Nova Scotia, New Brunswick and Quebec the Ceiling reduces Entitlements in two years because of its interaction with the Floor payments in 2001-02.

Table B.3. Ceiling Impact on Receiving Provinces' Payments
2000-01 and 2001-02 Entitlements

Province	Ceiling Impact ($ Millions)
Newfoundland and Labrador	19.2
Prince Edward Island	**4.9**
Nova Scotia	33.7
New Brunswick	25.4
Quebec	198.2
Manitoba	20.5
Saskatchewan	18.3
Total	320.1

Source: Federal Department of Finance, PEI Treasury Calculations
Includes multi year impacts.

It is the Government of Prince Edward Island's view that the Ceiling should never have been imposed, because it is contrary to the principles of Equalization.

The federal commitment to remove the Ceiling for 2002-03 and future years is something of an empty promise in light of the reduced levels of Equalization Entitlements in these years. Table B.4 shows the decline in total Entitlements and the Ceiling amounts from 2000-01 to 2003-04 where one can see that the Ceiling in 2003-04 far exceeds Entitlements, and therefore has no effect.

Table B.4 Total Entitlements and Ceiling Amounts: 2000-00 to 2003-04

Year	Entitlements ($ Billions)	Ceiling
2000-01	11.1	10.9
2001-02	10.4	11.1
2002-03*	10.3	11.6
2003-04*	10.4	12.3

Source: Federal Department of Finance
** Ceiling Removed*

Comprehensive Revenue Coverage

One of the reasons for declining Entitlements, as shown in Table B.4 is the restriction that was placed on the amount of provincial revenue from user fees that are used in the calculation by the Federal Government. In the 1999 Equalization renewal the Federal Government implemented a radical change to reduce the amount of provincial revenue from user fees by 50 per cent in the Miscellaneous Revenue base in the formula by 2003-04.

The impact on receiving provinces by eliminating 50 per cent of user fee revenue coverage in the Miscellaneous Provincial-Local Tax and Revenue base for 2003-04 is shown in Table B.5. One can see that Entitlements were reduced by $464 million by the federal decision. For Prince Edward Island, Entitlements were reduced by $9.4 million per year.

Table B.5
Equalization Entitlements for the Miscellaneous Provincial-Local Tax and Revenue Base.

2003-04	User Fee Revenue Coverage		Reduced
	100%	50%	Entitlements
Province	$ Millions		
Newfoundland and Labrador	91.7	57.9	-33.8
Prince Edward Island	**22.7**	**13.3**	**-9.4**
Nova Scotia	114.1	66.0	-48.1
New Brunswick	115.8	67.6	-48.2
Quebec	413.3	249.5	-163.8
Manitoba	128.5	73.3	-55.2
Saskatchewan	108.4	58.8	-49.6
British Columbia	176.6	120.7	-55.9
Total	1171.2	707.1	-464.1

Source: Federal Department of Finance

Provincial governments have been pressing the Federal Government for comprehensive revenue coverage for the Equalization formula in order to restore this base in full.

Equalization Standard

The Government of Prince Edward Island is also concerned that the five province standard is becoming inadequate to meet the programs objectives.

Various Equalization standards have been used in the past including the average of the top two provinces, a national average standard and now the five province standard. The five province standard was adopted in 1982 to replace the national average or ten-province standard that was used to 1981. The five provinces in the standard are Québec, Ontario, Manitoba, Saskatchewan and British Columbia. This five-province standard excludes Alberta, with its high fiscal capacity as well as the four Atlantic provinces, Newfoundland and Labrador, Prince Edward Island, Nova Scotia, and New Brunswick, with their relatively low fiscal capacities.

Table B.6
Increase in Equalization Entitlements From a 10-Province Standard.
2003-04 Third Estimate.

Province	$ Millions
Newfoundland and Labrador	108.0
Prince Edward Island	**28.6**
Nova Scotia	192.8
New Brunswick	154.2
Quebec	1,521.2
Manitoba	234.8
Saskatchewan	206.4
British Columbia	854.4
Total	3,300.4

Source: Federal Department of Finance, PEI Provincial Treasury Calculations.

Table B.6 displays the increase in Entitlements for receiving provinces that would occur from adopting a 10-province standard in 2003-04. It is apparent that receiving provinces are presently Equalized to a standard that is considerably less than the national average. An Equalization program designed to bring provinces up to a national average standard would deliver an additional $3.3 billion in 2003-04. For Prince Edward Island this is an additional $28.6 million that year, though the amount is highly variable.

Moving to a 10-province standard would improve receiving provinces' ability to provide reasonably comparable services at reasonably comparable levels of taxation - it would also offset the negative impact caused by reduced revenue coverage. Total Entitlements as a share of GDP would rise from 0.9 per cent to approximately 1.138 per cent, which is closer to their level in earlier years.

3. 2001 Census of Population

Estimates of population are a critical component in determining the allocation of federal transfers among provinces and territories. The current population estimates used in the transfer calculations are subject to a major revision in the fall of 2003. At that time, Statistics Canada will release revised estimates of provincial and territorial populations based on the 2001 Census, adjusted for net under-coverage.

Equalization and CHST Entitlements for those years that have not been finalized will incorporate the new population data in the recalculation of Entitlements in October 2003. Box B.1 details how the population revisions impact on Prince Edward Island's transfers from the Federal Government which will affect Prince Edward Island's transfer revenues in the 2003-04 fiscal year.

Box B.1 Census Impact on Federal Transfers

On March 27, 2003 Statistics Canada released estimates of coverage errors in the 2001 Census of population. Estimates of the coverage errors show the proportion of the population that were either completely missed or enumerated more than once. Statistics Canada will incorporate the net coverage error for each province and territory into new population estimates to be released in September of 2003.

Analysis of the 2001 Census shows that Atlantic Canada's population grew at a slower rate than the annual population estimates currently used in the transfer programs indicate. Prince Edward Island's population share of the national total and of the five province standard is expected to fall.

Transfers based on a simple per capita allocation, such as the CHST and the Health Reform Fund, will fall by a proportional amount.

However, the impact on Equalization is more severe, as there are three negative forces at play. As described in Figure B.1 Equalization is determined by the difference in per capita fiscal capacity of a receiving province and the five province standard. This is multiplied by that province's population. Firstly, an increase in the population of the standard provinces reduces the five province fiscal capacity per capita. Secondly, a decrease in Prince Edward Island's population increases our per capita fiscal capacity. So the combined impact reduces the provinces per capita fiscal disparity. Thirdly, this is then multiplied by the revised, lower, population to give the revised total Entitlement.

Revised population data will impact Entitlements for the 2000-01 to 2003-04 fiscal years for Equalization and CHST.

4. Resolution of the Federal Misallocation of Income Tax Revenue

A year ago there remained considerable uncertainty over how the Federal Government intended to resolve the problem of the large overpayment of Personal Income Tax revenues to some provinces resulting from a federal accounting error. The federal Canada Customs and Revenue Agency issued a statement January 29, 2002 to indicate that because of a serious tax accounting problem, four provinces had received in excess of $3.3 billion in overpayments dating back to 1993, and possibly more, going back to 1972. This was referenced in last year's Provincial Budget Paper B and because it implicated the Equalization program, Prince Edward Island was in a position to lose Equalization in 2002 depending on the federal decision over recovery of the overpayments. The tax accounting problem concerned the way the value of Capital Gains earned by Mutual Fund Trusts were accounted for, and it was known as the T 3 issue.

On September 4, 2002 the Federal Minister of Finance made a decision concerning the overpayments, and the treatment of Equalization. The Minister noted that the Auditor General was able to verify the overpayments for the years 1997 to 1999 only, which amounted to $2.5 billion of the $3.4 billion total amount believed to have been overpaid since 1993. Of that amount $2 billion was overpaid to Ontario, $364 million to Manitoba, $96 million to BC and $3 million to Alberta. She also noted that an estimated $995 million in excess Equalization entitlements was paid to receiving provinces between 1997 and 1999 as a result of the excess tax revenues that were created.

Acknowledging that the problem was entirely the responsibility of the Federal Government the Finance Minister decided to limit the operable period to the 1997-1999 years, forego recovery of excess Equalization overpayments and allow an equivalent compensating adjustment to apply to all provinces. The result is shown in Table B.7.

Table B.7 Explanation of Resolution of the T3 Problem

Province	1997-1999 Overpayments	Equalization Impact	Equivalent Benefit	Final Amount to be Recovered
		$ Millions		
Newfoundland and Labrador	0	49	0	0
Prince Edward Island	0	13	0	0
Nova Scotia	0	84	0	0
New Brunswick	0	68	0	0
Quebec	0	607	0	0
Ontario	2,074	0	744	1,330
Manitoba	364	(202)	71	91
Saskatchewan	0	92	0	0
Alberta	3	0	3	0
British Columbia	96	285	96	0
Canada	2,537	995	914	1,421

Source: Federal Department of Finance

In the case of Prince Edward Island, the decision removed the provincial concern that an estimated $13 million of Equalization, that federal Finance claimed had been overpaid, would be recovered. It might be noted that Prince Edward Island and other Equalization receiving provinces disputed the validity of the federal claim, given the circumstances of the accounting error.

The effect of the federal resolution is to limit recoveries to Ontario, in the amount of $1.33 billion and to Manitoba, $91 million, for a total recovery of $1.4 billion. These recoveries will start in 2004-05 and are to be spread over 10 years.

The new arrangement also called for a revision to the Equalization formula backdated to 2001-02. This corrects the measurement of fiscal capacity in the formula, by removing the Mutual Fund T3 Capital Gains amounts from the Equalization income tax base. Manitoba received a one time payment of $140 million to compensate them for the problem that remains in the 2000-01 year's estimated entitlement. A negative adjustment to equalization entitlements for Prince Edward Island and other receiving provinces has resulted from this revision. For Prince Edward Island it amounts to approximately $3 million. This was one of the factors reducing Prince Edward Island's Equalization revenue in 2002-03.

BUDGET PAPER C:

CHANGES IN ACCOUNTING

AND BUDGETARY POLICY

BUDGET PAPER C:
CHANGES IN ACCOUNTING
AND BUDGETARY POLICY

This paper summarizes the changes in accounting and budgetary policy the Province has implemented in the current budget year. These changes are in accordance with the new recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants (CICA).

Consolidation

Consolidation refers to the preparation of budgets or financial statements to include the results of its own operations, as well as the results of operations of its subsidiary entities. The Province has prepared consolidated Financial Statements for several years; however, the Budget Estimates were not prepared on a full consolidated basis. In the current fiscal year, the Budget is prepared on a consolidated basis to enhance the presentation of consolidated financial statements. Table 2 lists all crown entities from Schedules "B", "C" and "D" of the *Financial Administration Act* and indicates which entities were previously excluded from the Province's bottom line. The Province either funded these entities through a grant for their total operations or provided a grant for their net operation. The Province's financial results will now report all assets, liabilities and annual operating surpluses/deficits of these entities except for government business enterprises where only their change in equity will be included.

The Provincial Budget has always included the operations of the four Health Regions, Provincial Health Services Authority, School Boards, Tourism PEI and P.E.I. Business Development Inc. Beginning with this Budget, the remaining entities, as outlined on Schedule 8 of the Budget Address, will be consolidated in a manner similar to government business enterprises. The majority of these entities have been established for research and insurance purposes and therefore will be consolidated on a net surplus or deficit position for budgetary purposes.

Government business enterprises, as listed on Schedule 8 of the Budget Address, are defined as those agencies, crown corporations and boards which, (i) have the power to contract in their own name, (ii) have the financial and operating authority to carry on a business, (iii) sell goods and services to customers outside the provincial reporting entity as their principal activity and source of revenue, and (iv) are able to maintain their operations and meet their liabilities from revenues received from sources outside the provincial reporting entity.

For the purpose of the current year's presentation, the surpluses and deficits of consolidated entities and government business enterprises have been grouped together.

Tangible Capital Assets

The Public Sector Accounting Board of the CICA, which establishes accounting standards for government bodies, has urged governments in Canada to adopt full accrual accounting. Most of the provinces and the Federal Government are following this standard. The Province has always used full accrual accounting with the exception of the recently released recommendation for capitalizing and amortizing tangible capital assets. As of this budget year, the Province will adopt the PSAB recommendation.

Tangible capital assets are non-financial assets of physical substance that are purchased, constructed, developed or otherwise acquired, and which: (i) are used in the production or supply of goods, delivery of services or program outputs; (ii) have a useful life extending beyond one year; and (iii) are not intended for resale in the ordinary course of operations. Accounting standards for government entities require that the cost of tangible capital assets be amortized over the useful life of each asset.

Tangible capital assets of the Province will include construction, major additions and repairs to bridges, roads, schools, hospitals, parks, government and health facilities and purchase of buildings; major equipment; road machinery and buses. This will not include road repairs such as patching and culverts.

Tangible capital assets will be recorded at their original cost. Provincial assets will be amortized on the straight-line basis over their useful life. In the year of an asset's acquisition, amortization is recorded at half the normal rate. For budgetary purposes amortization is recorded as follows:

Bridges	Amortized over 40 years
Roads	Amortized over 20 years
Buildings	Amortized over 40 years or less
Major Equipment	Amortized over 5 years
Road Machinery & Buses	Amortized over 10 years

Crown corporations have been encouraged to follow accounting practices that are consistent with government.

Changes due to Implementation

The implementation of these new accounting and budgetary policies will not only improve accountability and stewardship reporting for the Province, but will also provide more detail as to the actual breakdown of the Net Debt position of the Province. Net Debt is defined as the government's liabilities minus its financial assets. Net Debt will be classified into two categories: accumulated deficit and tangible capital assets. Accumulated deficit is defined as the total of all surpluses and deficits of the government since its inception, plus any adjustments charged directly to the accumulated deficit. At March 31, 2004, it will represent 46% of total Net Debt figure of $1.1 billion. Tangible capital assets, as defined above, represent the other 54% of total Net Debt. This presentation provides a clearer understanding of the components of Net Debt. Schedule 4 of the Budget Address provides a breakdown of these two categories.

The implementation of these accounting and budgetary changes will result in a change in the Province's reported surplus or deficit. In order to facilitate comparability with the 2002-2003 Budget, which was prepared using different accounting and budgetary policies, the Budget Summary has been presented to show the effect of these changes. Table 1 is an alternative presentation of the Budget Summary to indicate the presentation which will be followed in future years.

Table 1
Prince Edward Island
Budget Summary Restated

	2003-2004 Budget Estimate
Revenue:	
Provincial Own Sources	$ 610,675,100
Federal Sources	$ 404,107,600
Sinking Fund Earnings	$ 13,225,000
	$1,028,007,700
Expense:	
Program Expense	$ 907,545,600
Interest Charges on Debt	$ 105,408,600
Amortization	$ 25,442,300
Net Deficit of Crown Entities	$ 1,103,200
	$1,039,499,700
Consolidated Deficit	($11,492,000)

Table 2
Provincial Crown Entities

Prince Edward Island Agricultural Insurance Corporation*
Prince Edward Island Business Development Inc.
Prince Edward Island Employment Development Agency
Prince Edward Island Housing Corporation
Prince Edward Island Energy Corporation*
Prince Edward Island Liquor Control Commission
P.E.I. Lending Agency
P.E.I. Self Insurance and Risk Management Fund*
Island Investment Development Inc.*
Island Waste Management Corporation*
Prince Edward Island Crown Building Corporation
Prince Edward Island Grain Elevators Corporation*
Prince Edward Island Lotteries Commission
Prince Edward Island Special Projects Fund*
Prince Edward Island Museum & Heritage Foundation*
PEI Agriculture Research Investment Fund Inc.*
Charlottetown Area Development Corporation*
Summerside Regional Development Corporation*
PEI Aquaculture and Fisheries Research Initiative Inc.*
Tourism PEI

Western School Board
Eastern School District
La Commission Scolaire de langue française
Southern Kings Regional Authority
Eastern Kings Regional Authority
Queens County Regional Authority
East Prince Regional Authority
West Prince Regional Authority

Island Regulatory and Appeals Commission
Prince Edward Island Human Rights Commission

* indicates entity previously excluded from Province's budgeted surplus/deficit